84-450

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.,
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

JURISDICTIONAL STATEMENT

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September 21, 1984

QUESTIONS PRESENTED BY THE APPEALS

1. Are the requirements of the Fifth Amendment satisfied by a just compensation award, entered in 1984 with respect to a 1976 taking, providing for the delivery of a Government debt obligation, rather than cash, in an amount equal to the valuation of the property taken, payable by December 31, 1987; and, if so, is not the interest rate accruing on the debt obligation of 8%, compounded annually from the date of the taking, constitutionally inadequate since (a) it causes the fair market value of the obligation at the time of its delivery to be 15% less than its face value and (b) it fails to compensate the condemnee for the loss of much greater yields generally available during the period of delay on conservative debt securities?

2. Are the just compensation requirements of the Fifth Amendment satisfied when the Government takes for continued rail use an operating rail system that has been incurring losses and pays an amount measured solely by a scrap valuation of the assets which assesses penalties for the rail use values transferred and takes various sales, title and other liquidation deductions inconsistent with federal condemnation law?

3. If such discounted scrap values can provide just compensation, should they be determined with reference to actual markets existing at the date of the taking and contemporaneous assessments of such values by potential purchasers or should they be determined in the abstract by a judicial modeling of the scrap values realizable in hypothetical markets presumed to be glutted by the rail properties of other railroads simultaneously taken by the Government in the same project?

4. Did the valuation methodologies adopted by the Court below create undue risk of, and in fact lead to, speculative and arbitrary determinations?

5. Is a railroad entitled to severance damages measured by the costs of removal of its bridge over navigable waters where the rail property surrounding the bridge has been taken, rendering the bridge useless and outside the scope of the Truman-Hobbs Act, 33 U.S.C. § 501 *et seq.*, and obliging the railroad to remove it at its own cost as a navigational hazard?

THE PARTIES BELOW

The parties to the proceeding at the time of the entry of the judgment appealed from were:

1. the CNJ parties consisting of the following related companies each of whom is an appellant here, collectively referred to as "CNJ" or the "CNJ Appellants":
   a. The Central Railroad Company of New Jersey, now, as reorganized, Central Jersey Industries, Inc.*
   b. Dover & Rockaway Railroad Co.
   c. Mt. Hope Mineral Railroad Co.
   d. Wharton & Northern Railroad Co.
   e. Central Railroad Co. of Pennsylvania
   f. Communipaw Central Land Co.
   g. Bay Shore Connecting Railroad.
2. the Government Parties consisting of:
   a. United States Railway Association (USRA)
   b. United States Department of Transportation (USDOT)
   c. United States of America
   d. Consolidated Rail Corporation (Conrail)

The proceedings initially had numerous other parties whose participation has ceased as a result of settlements and other transactions.

* Central Jersey Industries, Inc. is the parent company of the other Appellants. There are no other subsidiaries or affiliates of any of the Appellants other than wholly owned subsidiaries. This jurisdictional statement is filed on behalf of all Appellants.

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CENTRAL JERSEY INDUSTRIES, INC., a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

JURISDICTIONAL STATEMENT

THE OPINIONS BELOW

The final judgment appealed from arises out of determinations made in the course of a number of opinions rendered by the Special Court in *In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act of 1973*, a proceeding to set the compensation payable to various Northeastern railroads in reorganization for compelled transfers of their assets to Conrail and others. The pertinent determinations appear in the opinion at 425 F. Supp. 266 outlining procedures to be followed and issues to be addressed (CA-30)[1]; the opinion at 439 F. Supp. 1351 concerning the issue of compensable unconstitutional erosion (CUE Opinion) (CA-77); the opinion at 445 F. Supp. 994 concerning principles to govern the determination of net liquidation values and constitutional minimum values under the Rail Act (CMV Opinion) (CA-160); the opinion at 531 F. Supp. 1191 concerning certain valuations and determinations as to continued rail use (Rail Use Opinion)

1. The references to the Appendix volumes hereto have been designated as (CA-xxx).

(CA-266); the opinion at 571 F. Supp. 1269 concerning the nonrail use valuation of CNJ's transferred assets (CNJ Opinion) (CA-677); the opinion deciding petitions for reconsideration of the CNJ Opinion *id.* at 1335 (CA-792); the unreported opinion resolving remaining disputes as to the implementation of the principles set forth in the CNJ Opinion (CA-807); and the unreported opinion disposing of CNJ's claim for severance damages and its claim for delay damages over and above the interest provided by the statute (Severance/Delay Damage Opinion) (CA-815).

THE GROUNDS OF THE SUPREME COURT'S JURISDICTION

These appeals are from the final judgment of the Special Court issued under § 303(c) of the Regional Rail Reorganization Act of 1973, as amended (the Rail Act), 45 U.S.C. § 743(c) entered on July 23, 1984. The CNJ parties filed their notices of appeal to this Court in the Special Court on July 30, 1984. Jurisdiction of these appeals are conferred upon this Court by § 303(d) of the Rail Act, 45 U.S.C. § 743(d).

CONSTITUTIONAL PROVISIONS AND STATUTES

Fifth Amendment, United States Constitution:

> ... nor shall private property be taken for public use, without just compensation.

Statutes: § 303(c)(d) of the Rail Act, 45 U.S.C. § 743(c)(d), and § 306 of the Rail Act, 45 U.S.C. § 746.[2]

STATEMENT OF THE CASE

These appeals arise out of the valuation proceeding conducted by the Special Court (i) under § 306 of the Rail Act, 45 U.S.C.

2. The texts of the cited statutory provisions are contained in Appendix Q. (CA-884 *et seq.*)

§ 746, determining the net liquidation value and other components of the certificates of values to be issued by USRA as compensation to various transferors who conveyed rail properties to Conrail and others and (ii) under § 303(c) of the Rail Act, 45 U.S.C. § 743(c), determining whether the terms of the mandated exchanges satisfy constitutionally minimum standards. The constitutionality of the Rail Act in its initial form was sustained by this Court in the *Rail Act Cases*, 419 U.S. 102 (1974); and the reorganization of CNJ and other transferors under its terms was required by the Special Court in *In the Matter of Penn Central Transportation Co., et al.*, 384 F. Supp. 895 (Regional Rail Reorg. Ct. 1974).[3]

On April 1, 1976 most of the rail assets of CNJ and of the other transferors were transferred to Conrail pursuant to the order entered by the Special Court under § 303(b) of the Rail Act, 45 U.S.C. § 743(b). The valuation proceeding commenced about that time and initially addressed the compensation to be provided for the assets of all transferors. As a result of various settlements the claims of the present appellants are the only claims that remain outstanding under § 303(c), 45 U.S.C. § 743(c).

At the time of the conveyances, CNJ was a Class I railroad based in the northern New Jersey metropolitan area with lines extending to the western and southern borders of the State. CNJ originated and terminated important freight traffic, particularly that moving to and from the concentrated industrial area extending from Newark to the Amboys, known as the "Chemical

3. These initial cases concluded that the Rail Act was a valid reorganization statute enacted pursuant to the bankruptcy power. At that time, the anticipated compensation for the asset transfer was principally the securities of Conrail, the reorganized railroad contemplated by the Rail Act. A subsequent amendment added certificates of value to the compensation package, guaranteeing certain recoveries on the Conrail securities; 45 U.S.C. § 746, added by Pub. L. 94-210, Title VI, § 610(b), 90 Stat. 104 (1976), but a later amendment withdrew the Conrail securities from the compensation. 45 U.S.C. § 1115, added by Pub. L. 97-35, Title XI, § 1167(b), 95 Stat. 686 (1981). The government conceded, during the course of the proceedings below, that the adequacy of the compensation is to be measured by the standards governing the taking clause of the Fifth Amendment. *CMV Opinion*, 445 F. Supp. at 1000 (CA-168-69).

Coast". The freight services performed by CNJ were found to be essential by both the Secretary of the USDOT acting pursuant to the Emergency Rail Services Act, 45 U.S.C. § 601 and New Jersey transportation officials. *Rail Use Opinion,* 531 F. Supp. at 1379 (CA-578). CNJ also provided extensive commutation services within the State of New Jersey under subsidy arrangements which CNJ considered confiscatory.

CNJ had been in reorganization under § 77 of the Bankruptcy Act, former 11 U.S.C. § 205, since March of 1967 and had incurred operating losses for many years. In 1971 it undertook a broad revitalization program to restructure freight operations and to improve commuter subsidy arrangements. There was progress in restructuring the freight operations, *see Central R. Co. of New Jersey—Abandonment,* 342 I.C.C. 227 (1972) and *Routing via Oak Island Junction,* 341 I.C.C. 129 (1972); but CNJ's efforts to place its passenger operations on a compensable basis which, it believed would permit an income based reorganization, were impeded by the decision in *In the Matter of The Central Railroad Company,* 485 F.2d 208 (3d Cir. 1973), *cert. denied sub nom. Timpany* v. *New Jersey,* 414 U.S. 1131 (1974).[4]

The Rail Act became law on January 2, 1974. CNJ, as the Special Court has noted, opposed both the passage of the Act, *CUE Opinion,* 439 F. Supp. at 1379 n.45 (CA-114, 149), and its reorganization thereunder, *In the Matter of Penn Central Transportation Co.,* 384 F. Supp. at 951 n.115, even with the availability of the Tucker Act to remedy any "shortfall" in compensation. *Rail Act Cases,* 419 U.S. at 125-48. CNJ was concerned that the Rail Act required it to trade known acceptable alternatives for the greater uncertainties of a delayed judicial assessment of their value. This concern was borne out by subsequent events.

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4. The Third Circuit held, *en banc,* that the CNJ Reorganization Court lacked the power to enter an order that might have led to the cessation of passenger operations because the estate's progress in the reorganization precluded a finding that continued operations threatened an unconstitutional taking. 485 F.2d at 215-16. Congress subsequently provided such power to reorganization courts in the railroad reorganization provisions of the Bankruptcy Code. *See* 11 U.S.C. § 1170.

Prior to Congress's active consideration of the Rail Act, CNJ's preferred alternative was to continue operating under a program that sought improved passenger subsidies, rail consolidations and the positioning of CNJ as a neutral terminal company in New Jersey prepared to take over the traffic of other railroads which were seeking to withdraw.[5] After passage of the Rail Act, CNJ's reorganization effort evolved toward a potential sale of its rail system to the State of New Jersey. CNJ had been exploring with the State since 1971 the possibility of changing its avoidable cost subsidy contract into a full cost of service passenger contract with provision for a return on its investment in the facilities used in passenger service. In early 1974 these discussions were expanded to include the consideration of a purchase by the State of all of CNJ's New Jersey rail facilities. By the summer of 1974 the Commissioner of Transportation had been engaged for more than six months in serious discussions of this subject with various representatives of bondholders, the Trustee, the reorganization judge, and key federal officials at USDOT, UMTA and USRA. The NJDOT had agreed to major improvements in passenger subsidy arrangements and to provide substantial funds for main-line rehabilitation. These and other favorable developments led the reorganization court on July 15, 1974 to state at a hearing:

> I have a very, very strong feeling, based on my knowledge of the case from its beginning, that the flame at the end of the tunnel is brighter than it ever was before.[6]

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5. The Court stated in the *CUE Opinion*, 439 F. Supp. at 1382 (CA-119) "The Trustee has made a rather impressive showing that Congress' consideration and enactment of the Rail Act had a particularly negative effect on the CNJ" noting, as well, that the Act had brought to a halt important negotiations with other railroads for acquisition of its facilities. *Id.* at n.55 (CA-118, 151).

6. The reorganization court's intimate knowledge of the underlying asset values of the estate, as well as of its progress and alternatives, had previously led it to reject various efforts by creditors to obtain cessation of railroad operations and dismiss the proceedings. See oral opinions of the Honorable Anthony T. Augelli, *In the Matter of The Central Railroad Company of New Jersey*, No. B 401-67 (D.N.J.) of Mar. 26, 1971 and Dec. 8, 1972 (CA-912, 923).

In the Matter of the Central Railroad Company of New Jersey, No. B 401-67, Hearing Record at 15 (D.N.J. July 15, 1974) (Augelli, J.). By the end of July, 1974, the negotiations over the sales price had narrowed to the range of $80 to $105 million.[7]

At the time of these discussions, the State had available to it an extensive scrap study prepared by Wyer, Dick & Co. for the CNJ estate, finding a scrap value for CNJ's assets at June 30, 1968 of $79,600,000,[8] and a detailed analysis of that study prepared by DeLeuw Cather & Co. for the State of New Jersey in 1971 which concluded that CNJ's scrap value as of June 30, 1968 was approximately $91,500,000. The Commissioner decided to update these studies in connection with the negotiations; and in late July of 1974, the State retained L. E. Peabody & Associates to perform a further study and directed that James Hyde, the Director of the Rights of Way Division of the New Jersey DOT also perform an additional independent valuation. These studies were completed by the end of the summer; and each contained valuations based upon various methodologies, including scrap. The scrap value found by L. E. Peabody & Associates was $112,981,000; and the Rights of Way Division found a scrap value of $121,000,000 for just the real estate and track materials. However, the negotiations for the purchase of the CNJ came to an end when the Special Court issued its opinion under § 207(b)

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7. In its *Rail Use Opinion*, 531 F. Supp. at 1377 n.339 (CA-577, 657), the Special Court expanded the range of prices beyond that actually under consideration by including prices referred to in various valuation studies. The range in the actual negotiations was significantly narrower, both parties accepting the concept that the State would pay all debts superior to the CNJ's outstanding bonds with something "on top" for the bonds. The CNJ trustee quantified these debts as $80 million and proposed an additional payment of $25 million. The State's own internal memoranda suggested the Commissioner's willingness to pay an additional $10-15 million.

8. Wyer, Dick & Co. stressed in its study that the net liquidation values shown were hypothetical values based upon unrealistic assumptions that the railroad would be dismantled and its patrons denied service. It opined that higher values would be obtained if certain of the CNJ lines would be sold in place for continued rail use; and it pointed out that scrap prices had risen substantially from the June 30, 1968 "as of date of study". The analysis prepared by DeLeuw Cather & Co. for the State of New Jersey confirmed those observations.

of the Rail Act, 45 U.S.C. 717(b) holding that, subject to the outcome of the *Connecticut General* case,[9] CNJ and the other railroads in reorganization in the Northeast would be reorganized under the Rail Act. *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 984.

On April 1, 1976 CNJ, pursuant to the § 303(b) order of the Special Court, conveyed almost all of its rail system to Conrail. This included approximately 700 miles of track, 3,400 acres of real estate, all of its rolling stock, equipment, and other rail assets.[10] Excepted from the conveyance was a major structure, the Newark Bay Bridge, which linked CNJ's rail facilities on the Bayonne peninsula with its rail facilities in Elizabeth—though the right of way to the west of the Bridge in Elizabeth and to the east of the Bridge in Bayonne was conveyed and Conrail was given an easement over the Bridge for as long as it utilized the Bridge in providing commuter service to Bayonne. The commuter service was terminated in 1978; and the Coast Guard then notified CNJ of its intention to issue an order directing CNJ as the owner of the Bridge to remove it under the Bridge Act of 1906, 33 U.S.C. § 494, at a cost estimated by the government to be approximately $14 million.[11]

In September of 1979 CNJ consummated a plan of reorganization disposing of more than $160 million in creditor claims. *In the Matter of The Central Railroad Company of New Jersey*, 473 F. Supp. 225 (D.N.J. 1979). Most of the creditors, including its largest, the United States, were given various interests, according to established priorities, in such proceeds as would ultimately be derived from the valuation case.

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9. *Connecticut Gen. Ins. Corp.* v. *United States Ry. Ass'n*, 383 F. Supp. 510 (E.D. Pa.), *rev'd sub nom Regional Rail Reorganization Cases*, 419 U.S. 102 (1974).

10. The State of New Jersey thereafter purchased from Conrail substantial portions of CNJ's lines.

11. In prior years the Coast Guard had determined that the Bridge constituted a hazard to navigation and had offered to alter it pursuant to the Truman-Hobbs Act, 33 U.S.C. § 501 *et seq.*, under which the United States would have paid substantially all of the alteration costs. *Severance/Delay Damage Opinion, slip op.* at 29 (CA 838).

The litigation of the valuation case proceeded in four stages: (1) the briefing, argument, and determination of various legal issues—principally the statutory and constitutional principles to govern a trial of the compensation to be paid; (2) a trial of the rail use issues—identifying the rail assets which would be sold for rail use if, hypothetically, all transferors sought to dispose of all their rail assets at the same time, and, to the extent feasible, arriving at a sales price; (3) a trial of the scrap value of CNJ's conveyed assets; and (4) a trial of CNJ's claims to be compensated for severance damages to the Newark Bay Bridge and for delay damages in excess of the 8% compounded interest accruing on the certificates of value to be issued under Section 306 of the Rail Act, 45 U.S.C. § 746. None of the trials were conducted in the presence of the Court. Instead, each proceeded by the submission of written testimony, followed by discovery and/or cross examination upon deposition, with a subsequent designation of a record, briefing, argument, and decision.

The final result of the entire process was the entry of a judgment fixing the net liquidation value of the assets conveyed by CNJ and certain of its affiliates at approximately $42.5 million with direction to USRA to deliver certificates of value in that amount bearing interest at the rate of 8% compounded annually from the date of the taking on April 1, 1976 to the date of their redemption which is to occur not later than December 31, 1987.[12] The Special Court rejected CNJ's contentions that its net liquidation value under Section 306 was higher, that such value was less

12. Section 306(c) of the Rail Act requires a determination of the base value of the certificates of value to be issued thereunder by USRA. The essential elements of such base value are: (i) the net liquidation value of the assets transferred; (ii) a reduction for the value of other benefits received by the transferor under the Rail Act; (iii) an addition for the amount of compensable unconstitutional erosion to which the transferor was entitled; and (iv) an addition of interest from the transfer date to the redemption date at the rate of 8% per annum, compounded annually. The parties stipulated that the value of other benefits and the amount of compensable unconstitutional erosion were zero. The Court found the net liquidation value to be $42.5 million and the interest accrued thereon at the statutory rate approximates $37.5 million at June 30, 1984.

than the constitutional minimum required to be paid under Section 303(c), and that, under Section 303(c), it was entitled to additional delay and severance damages.

In arriving at the net liquidation value of $42.5 million, the Special Court constructed a liquidation model under which the transferred assets were assumed to be dismantled and sold over an eight-year period. It was assumed that rolling stock, ties, rail and other track materials would be disposed of in markets glutted by assets of other transferors who were presumed to be going through a similar scrapping process. These assumptions increased available supply competing with CNJ's dismantled assets and decreased demand for such assets by eliminating the other transferors as potential purchasers—leading to the hypothetical conclusion that large volumes of CNJ's rail and other track material, ties and rolling stock used in providing rail service at the time of the taking and thereafter should be classified as suitable only for scrap or worthless, rather than as reusable material, and to a reduction in prevailing unit prices for many of such assets. We estimate that projected disposition proceeds were reduced by as much as $10 million as a result of this glutted market assumption. Moreover, no values were allowed for various improvements to the properties, made at a cost of many millions of dollars, such as grading, fill, ballast, and structures useful only for rail purposes; and nothing was included for either the costs or the value of the assemblage of the extensive real estate parcels into an inter-connected system of rights-of-way and yards. Instead, penalties were generally imposed because of the existence of such improvements which were essential to the use and transfer of a going railroad. Real estate appraisals were reduced by the costs of removing buildings useful only for rail purposes and the costs of bringing the land to a level state; and such appraisals were further reduced by a variety of costs presumed to be incurred in disposing of the real estate parcel by parcel over a projected eight-year disposition period.

Large deductions were taken from the projected sales proceeds for hypothetical disposition and overhead costs and to account for

delays in realization. $5.4 million was deducted for the costs of dismantling the track facilities; $2.1 million was deducted for the costs of a liquidation organization; $1.1 million was deducted for delay in disposing of the non-real estate assets; and the fair market value of the real estate at April 1, 1976 ($34.2 million as found by the Court) was reduced by $14.2 million. The components of the $14.2 million in real estate costs include a reduction of 7% from appraised values for reversionary title (presumed to come into effect with the cessation of rail use); a reduction of 10% of projected sales proceeds, principally for taxes and other net holding costs presumed to be incurred over an eight-year disposition period; and a net yearly reduction of 12.22% of projected sales proceeds to present value those proceeds from the date of their projected receipt back to the taking date of April 1, 1976.[13] These reductions from real estate values were made notwithstanding clear evidence that the real estate appraisals had already taken into consideration contemplated future taxes and other holding costs, delays and difficulties in disposition,[14] and probable appreciation over time.

Most of the proceedings below were devoted to a trial of the net liquidation value of the assets transferred required by § 306(c).[15] The Court had held that the statutory meaning of "net liquidation value" embraced dispositions for any use (and not just for junk), *CMV Opinion*, 445 F. Supp. at 1004 (CA-177), and concluded

13. Appraisal values were appreciated by 3% per year; but annual projected proceeds were discounted by 15.22% per year to present value their worth to April 1, 1976. The Court made no adjustment for earnings on the sales proceeds that would have been realized; and since interest on the ultimate recovery was limited to 8%, a significant loss in value has been the result.

14. For example, the appraisals attributed no value at all to many right-of-way parcels and discounted the value of other parcels by as much as 95% of prevailing "across the fence" values for normal acreage in the relevant areas.

15. Since Section 306 required that each transferor prove its own net liquidation value, the Second and Sixth Pretrial Orders directed all transferors to prove what their properties would bring on the assumption that each would seek to dispose of all of their assets for continued rail use or for scrap. The assumption, though unrealistic, drove the resulting values down since they led to glutted market conditions for both types of sales.

that the transferors should prove the value of their transferred assets in assumed dispositions for continued rail use and for scrap. *Id.* at 1008-10 (CA-185-90). The Court noted, in discussing the problems facing the transferors in proving rail use sales, that the Government had been well-advised in conceding "that it would not demand proof that the transferors had received actual offers at identifiable prices", *id.* at 1008 (CA-185), and that "the Government Parties might be well advised not to be overly finical in their attitude toward such proof." *Id.* at 1030 (CA-227).[16]

In its opinion disposing of the rail use issues, the Court reviewed the evidence of New Jersey's negotiations for the purchase of the CNJ and concluded:

> Three days later negotiations effectively stopped when this Court decided that CNJ should be reorganized under the Act, *180-Day Appeals*, 384 F. Supp. at 954-55, 987-89.
>
> This train of events substantiates CNJ's assertion that, up until that decision, New Jersey had shown great and increasing interest in purchasing CNJ. Despite this, *it is far from certain* that the State would have actually carried out such a project. On the contrary, neither Sagner nor any one else in State government was ready to make any final decision on the matter. (emphasis added).
>
> *****
>
> In short, although the record suggests that Sagner pursued and probably favored a State purchase, it does not bear out the allegation that New Jersey was on the verge of buying CNJ's entire system. On the contrary, we cannot conclude with any confidence that any State purchase

16. Despite these views, the Second Pretrial Order, establishing the framework for a trial of rail use values, emphasized the desirability of the transferors coming "as close as possible" to the goal of joining "in a single scenario describing a particular purchaser for each route segment" and adopted the Government's proposal "for a single trial encompassing all rail uses" of all transferors. (CA-902, 904) The issue of whether such a disposition process would ever have occurred was never set for trial as the Government repeatedly contended that what actually would have occurred was unknowable and immaterial. *Rail Use Opinion*, 531 F. Supp. at 1211-12 (CA-295-96).

> would have occurred at all. There are simply too many unknowns, too many decisions not yet made, too many important actors still absent from the stage, to permit that.

Rail Use Opinion, 531 F. Supp. at 1377-78 (CA-575-77). Having rejected the evidence of CNJ's actual sales negotiations with the State of New Jersey as a basis for determining the disposition value of CNJ's rail system for continued rail use, the Court nevertheless, concluded that, if the Rail Act had never been enacted and if all the railroads in reorganization in the Northeast had sought to dispose of their properties at the same time, all of CNJ's rail assets would have been acquired for continued rail use by the State of New Jersey, *id.* at 1379 (CA-578-79), on or about April 1, 1976 pursuant to an agreement negotiated in late 1973 with the properties valued as of January 1, 1974. *Id.* at 1311 (CA-466). The Court further concluded that the price paid would have been set with reference to some variant of scrap value, called X and left the determination of X to the next phase of the case. *Id.* at 1382-83 (CA-584).

The Sixth Pretrial Order governed the trial of the scrap value issue. The *Rail Use Opinion* had indicated that the value perceptions of the potential purchaser were significant:

> What counts [in a single bidder situation] is what the buyer would have perceived the seller's likely receipts from dismantling or condemnation to be.

Id. at 1220 (CA-310).

> These beliefs are important in predicting public body actions in the alternative scenario because prices can only be based upon X as perceived by the parties to the negotiations, and not upon some other figure determined by hindsight.

Id. at 1329 (CA-495-96); and the Sixth Pretrial Order directed the parties to submit:

> the balance of their direct cases not later than December 1, 1981 (including with regard to lines kept in rail use but

> sold for a price based on non-rail use values, any adjustments for the perceptions of the parties negotiating or otherwise setting the sale price).

(CA-909). On the perceptions issue, CNJ relied heavily on the three scrap value studies, referred to above at page 6, that the State had commissioned—the DeLeuw Cather study and the studies prepared by L. E. Peabody and the Rights of Way Division in connection with the 1974 purchase negotiations. CNJ submitted detailed testimony of expert witnesses which specifically identified the values assigned in such studies to the assets transferred to Conrail and independently priced the small amount of new assets which CNJ had acquired subsequent to 1974 and conveyed to Conrail. This testimony concluded, after certain proposed reconciliations of differences between the studies, that the State of New Jersey perceived the 1974 net scrap value of CNJ's transferred assets as approximately $72.8 million.[17]

The Special Court in the *CNJ Opinion* rejected this historical evidence as to how the State would have perceived CNJ's scrap values stating:

> We are left with two conflicting impressions. One is that, on the basis of the appraisals, Sagner would have returned to the bargaining table with an offer which exceeded not only the GP's presently asserted scrap value figure [$23 million] but the higher scrap value figure we have found. [$42.5 million] For one reason or another the minds of all concerned in 1974 were attuned to a higher scale. There is, for example, no evidence that in 1974 New Jersey entertained such ideas as that all of CNJ's ties and much of its rail was valueless, largely because of glut, although perhaps it ought to have done so. The other impression is that we have no sufficient basis for finding what New Jersey's offer would have been. For one reason, neither the Peabody report nor the Hyde report gave any satisfactory notion of the liquidation value of

17. This was about $11 million less than the litigation scrap model that CNJ's experts submitted for an April 1, 1976 value under the prevailing market prices for the dismantled assets and about $50 million more than the litigation scrap model submitted by the Government's experts.

> CNJ's real estate, as CNJ's expert Van Horn conceded. We cannot assume that the State would have entered into serious negotiations when one of its figures with respect to such a major item was more than 150% of the other. Perhaps there might have been a split-the-difference approach, perhaps New Jersey would have commissioned a new appraisal of the real estate, perhaps something else would have occurred—we simply do not know . . . we cannot properly award judgment on the basis of mere speculation. *CNJ has simply not met its burden of showing by clear and convincing evidence* that, after the Peabody and Hyde appraisals were available, New Jersey would have made an offer at any ascertainable figure, and we therefore need not discuss what the result should be if CNJ had carried its burden on the facts. (emphasis added)[18]

CNJ Opinion, 571 F. Supp. at 1284 (CA-689-90).

Having eschewed evidence as to how the State of New Jersey *actually perceived* CNJ's scrap values, the Court then proceeded to determine how those values *should have been perceived* by New Jersey by constructing a judicial scrap model, picking and choosing from various parts of the scrap models submitted by both parties and filling in—we contend out of "whole cloth"—perceived interstitial gaps in the materials before it. It arrived at the net liquidation valuation of $42.5 million. There is no evidence in the record that the State ever viewed or would have viewed the scrap value of the CNJ at such a low level or that CNJ would have agreed to dispose of its rail assets for so little.

CNJ contends that the Special Court erred in substituting its own judgment as to scrap values for those actually held by the parties in interest and that it committed numerous errors in the course of constructing its judicial scrap model. However, the central issues raised on this appeal do not turn upon whether the Special Court properly interpreted or applied the words "net liquidation value" as used in Section 306(c) of the Rail Act. The

18. The words italicised here as well as in the quotation at page 11 above demonstrate the unduly strict standard of proof to which CNJ's evidence was subjected.

basic issue on the appeal concerns constitutional entitlement and whether the scrap valuation derived satisfies the requirements of the just compensation clause of the Fifth Amendment.

Section 303(c) of the Rail Act entrusts the Special Court with the obligation of determining whether the certificates of value to be issued under Section 306 of the Rail Act satisfy the constitutional minimum which CNJ is entitled to receive for the taking of its assets.[19] We contend they do not in three respects. First, the scrap valuation made of the conveyed assets does not adequately measure in the constitutional sense the value of an operating rail system taken for continued rail use. Second, the certificates of value, being a debt obligation of the United States, accruing interest at only 8%, compounded annually, is a constitutionally inadequate form of compensation because their present market value is approximately 15% less than their face value and because they inadequately measure the delay damages CNJ has suffered since 1976 by virtue of being deprived of the value of the property taken. Third, the certificates of value do not compensate at all for the severance damage caused to CNJ's ownership of the Newark Bay Bridge which was excluded from the mandated conveyances.

The Special Court addressed the form of the compensation as well as the constitutional valuation standard prior to the submission of any evidence. On the former, it sustained the form of the compensation provided by the Rail Act, holding that payment in cash was not a constitutional requirement. *CMV Opinion*, 445 F. Supp. at 999-1004 (CA-167-76). As for the latter, it determined that, at least initially, market value should be viewed as the measure of just compensation, subject to the caveat that an alternative standard—such as one related to depreciated original cost—might be used if market values were too difficult to prove or

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19. The controlling test in Section 303(c) is whether the transfers were "fair and equitable . . . in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under Section 77 of the Bankruptcy Act". The Special Court interpreted the test as meaning whether the compensation satisfied constitutional minimum standards under the Fifth Amendment. *Severance/Delay Damage Opinion*, slip op. at 4-6 (CA-817-19).

led to an unfair result. *Id.* at 1029-31 (CA-226-30). The Court went on to note that it "would not be surprised to find that revised market value figures were not much different from depreciated original cost."[20] *Id.* at 1031 (CA-230).

The Court in the same opinion rejected the relevance of a variety of other measures of value, and noted the Government had been unable

> to produce a single decision in which a losing public utility being taken for continued use was valued as scrap and the opinions convey a sense that such a solution would be unacceptable, at least if scrap value were negligible.

CMV Opinion, 445 F. Supp. at 1027 (CA-222-23).[21] Notwithstanding this, the Special Court concluded almost *sub silencio* in the course of processing the case through its various phases that it was appropriate, in the constitutional sense, to limit CNJ's just compensation to scrap values assessed in artificial glutted markets that, it was assumed, might exist if the Rail Act had not been enacted and all transferors would have been scrambling at the same time to dispose of all their assets. The Court held that the net liquidation value it found under § 306(c) of the Rail Act met just compensation standards. *In re Valuation Proceedings Under §§ 303(c) and 306 of the Regional Rail Reorganization Act of 1973*, Misc. No. 76-1, slip op. at 8 (Regional Rail Reorg. Ct. Dec. 5, 1984) (CA-812). We contend this was error for the reasons set forth in the following section of this Statement.

The remaining major issues were decided by the Special Court in its opinion of June 15, 1984. CNJ had contended that, under Section 303(c)(2)(C) of the Rail Act, 45 U.S.C. § 743(c)(2)(C), a supplemental judgment should be entered against Conrail awarding CNJ an amount of delay damages equal to the difference between the amount of interest accruing on the certificates of value at their statutory rate of 8%, compounded annually, and the amount that would be payable if the interest accrued during the delay period at market rates for conservative debt securities, such as the average annual rates prevailing on long term, corporate bonds rated Aaa, compounded

20. CNJ's evidence shows that the depreciated original cost of its conveyed assets was $63.3 million, exclusive of assets transferred by any of its affiliated companies.

21. The Special Court recognized that the *New Haven Inclusion Cases*, 399 U.S. 392 (1970), "do not qualify for this role", *CMV Opinion*, 445 F. Supp. at 1027 n.42 (CA-222), since the parties to the transaction had agreed upon the use of liquidation values as the basis for valuing the properties being transferred.

annually. The difference using such a measure approximates $22 million for the period April 1, 1976-June 30, 1984 and threatens to continue to grow dramatically through December 31, 1987 in view of the high current interest rate levels.[22] CNJ also contended that the supplemental judgment should direct Conrail to reimburse CNJ for severance damages in the form of expenses to be incurred in removing the Newark Bay Bridge. The Government has estimated that approximately $14 million in such expenses will be required to remove the Bridge.

The Special Court in the *Severance/Delay Damage Opinion* determined that the statutory rate was adequate in light of the interest rates on eleven year government obligations prevailing at the time of the taking and the deference to be given to the Congressional determination to use this rate in addressing the Northeast rail crisis. The Special Court also rejected the claim for severance damages on the ground that the injury was not cognizable as severance damages and because, it found, that CNJ would have borne the expenses in the absence of the Act.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

The within appeals present substantial questions of constitutional right, some of broad public applicability and significance, concerning the proper components and measurement of the just compensation to be paid in a taking of a utility's assets for continued use. Prior to the passage of the Rail Act, CNJ and other railroads had been compelled to provide uneconomic service to commuters and light density line freight users and to operate under other obsolete regulatory restraints which suppressed their earning power. CNJ sought regulatory relief of many types in various forums.[23] The relief ultimately came (*see*, for example, in addition to the provisions of the Rail Act concerning abandonment and subsidies for commutation and light density freight service, 45 U.S.C. § 744, the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210, 90 Stat. 33 (1976)

22. The difference would be substantial no matter which index (including those limited to government securities) is selected to measure conservative investment returns during the period of delay.

23. *See*, for example, those cited at page 4 as well as Contract Service Charges Between New Jersey Points, ICC I&S Docket No. 8702 (light density branch subsidies); Application for Authority to Use Certain Terminal Facilities, filed December 13, 1972, ICC Finance Docket 27265 (major consolidation proposal for Northern New Jersey); *In the Matter of Proposed Increase Central R.R.*, 125 N.J. Super. 48, 308 A.2d 370 (App. Div. 1973), *aff'd*, 66 N.J. 12, 327 A.2d 427 (1974) (denial of intrastate freight rate increase).

(codified as amended in scattered sections of 45 U.S.C. and 49 U.S.C.), the Bankruptcy Code 11 U.S.C. § 1170 and the Staggers Rail Act of 1980, Pub. L. 96-448, 94 Stat. 1898 (1980) (codified as amended in scattered sections of 49 U.S.C.), but too late to benefit CNJ.[24] The government, having suppressed the value of CNJ's assets, now seeks to take those assets, valued as "scrap" in artificial markets, to be used and disposed of for its benefit in a substantially ameliorated regulatory environment. This is fundamentally unfair. See *In re City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y.2d 212, 220-21, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966), *appeal dismissed sub nom. Fifth Avenue Coach Lines, Inc.* v. *City of New York*, 386 U.S. 778 (1967).

CNJ opposed the passage of the Act and its "reorganization" under it. It wanted to work out its own destiny; but most of its rail assets were taken under the Rail Act on April 1, 1976, leaving it with bits and pieces of retained property[25] and a bridge rendered useless by the taking and subject to a potential removal liability estimated at $14 million. No compensation was paid to CNJ on April 1, 1976. It has now been determined that the scrap value of the assets transferred is $42.5 million and that CNJ should receive government obligations in that face amount, bearing 8% interest, compounded annually from April 1, 1976 and redeemable no later than December 31, 1987. Because the 8% statutory rate has itself been rendered obsolete by the explosion in interest rates since 1976, the rate does not fairly measure the investment opportunities lost in the past 8 years; and it reduces the present worth of the certificates of value given in exchange for the assets.[26]

24. The impact of the more flexible regulatory climate now prevailing is evidenced by the favorable operating results of Conrail from a system comprised of lines of bankrupt carriers.

25. CNJ has realized over $20 million in cash from the partial disposition of these properties.

26. Federal obligations paying 8% interest and maturing in early 1988 were selling in the market place at about 85% of face value at the time of the Special Court's determination.

These facts raise substantial constitutional questions under the just compensation clause of the Fifth Amendment as to the valuation standard for the assets taken, the form of compensation and its adequacy to reimburse for the delay damages, and as to whether severance damages should be paid for the costs of the removal of the bridge. The answers provided by the Special Court to these questions were unprecedented and, we contend, unfair in the constitutional sense. It has held that the just compensation to be paid for a railroad taken for continued use (1) can be measured by scrap values; (2) need not be in cash nor in an amount sufficient to compensate for the lost investment opportunities during the period of delay; and (3) should not compensate for diminution in value to retained property rendered useless and converted to a liability by the taking.

A. THE QUESTION OF THE VALUATION STANDARD

CNJ will argue on these appeals that the scrap value of an operating rail system taken for continued rail use can never provide just compensation for that taking. There are two reasons for this. The first is that a scrap value standard fails to compensate for, and, in fact, penalizes the condemnee, for the values transferred, which is the lodestar of just compensation. *Kimball Laundry Co.* v. *United States*, 338 U.S. 1 (1949). The basic premise of all scrap valuations—i.e., the dismantlement and piecemeal disposition of the facility—is both unrealistic and irrelevant to the taking; and it deprives the owner of the value of his property for its highest and best use. The railroad is not going to be dismantled. The taking is not of piles of scrap and multiple, unrelated, parcels of real estate with their grades and cuts restored to natural levels; for the assets transferred were part of and will continue to be used as a going rail system.

> It involves a practical contradiction of terms to say that property useful and actually used in public service is not to be estimated as having the value of property in use, but is to be reckoned with on the basis of its 'junk value'.

City of Denver v. *Denver Union Water Co.*, 246 U.S. 178, 191 (1918). Scrap valuations not only fail to recognize any increments of value for the development of the integrated rail system which is transferred but also penalize the condemnee for the central elements of the values transferred by including deductions for costs presumed to be required to disassemble the properties and to restore them to their natural state. *See supra* pp. 9-10. The scrap valuation results in the condemnor receiving the assembled system for less than even the market price of the dismantled components. Yet, the taking was of a railroad for use as such; and the compensation to be "just" should reflect this fact and not be based upon a "junk" hypothesis.[27]

The second reason why a scrap valuation cannot produce a proper measurement of just compensation is that a number of deductions taken in the process of scrap modeling are inconsistent with principles of just compensation. For example, all scrap valuations take deductions for the expenses of selling and liquidating the properties; but such selling and liquidating expenses are never taken into consideration in determining the just compensation to be paid for property taken. When property is taken in the routine case, its fair market value is not reduced by selling commissions or other holding or disposition costs. Similarly, scrap value studies generally reduce real estate values by some factor thought appropriate to reflect reversionary interests in the title which are assumed to mature in a hypothetical liquidation.

27. This junk hypothesis cannot be justified here as the answer to the famous question of Justice Holmes of "what has the owner lost . . ." *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910). CNJ was not a venture seeking to liquidate as in *Market Street Ry. Co.* v. *Railroad Comm'n of California*, 324 U.S. 548 (1945) but a rail system committed to remaining in business with alternatives that it wished to pursue. It thought, before consideration of the Rail Act began, that its profitability could be restored; and there was unrebutted evidence below which suggested that such profitable results could have occurred if it were relieved of uncompensated passenger losses. The Special Court, without any evidence that CNJ intended, or was about, to be liquidated, prejudged the answer to Justice Holmes in directing that CNJ prove a disposition of its properties under the most unfavorable circumstances and equating the result to just compensation. What the CNJ lost was a rail system with a variety of favorable opportunities for which account was not taken.

However, eminent domain cases routinely ignore remote reverters, recognizing that to do otherwise is both to unfairly penalize the condemnee (since the reverter is remote) and to provide a windfall to the government (since it will pay nothing to the holder of the reverter). *Terminal Coal Co.* v. *United States*, 172 F.2d 113 (3d Cir. 1949); *United States* v. *635.76 Acres of Land*, 319 F. Supp. 763 (W.D. Ark. 1970), *aff'd per curiam*, 447 F.2d 1405 (8th Cir. 1971); *Santa Monica* v. *Jones*, 104 Cal. App. 2d 463, 232 P.2d 55 (1951); *Restatement of Property* § 53, Comment b (1936). Finally, and very important in the present case, some scrap studies apply a discounted cash methodology in determining sales proceeds by projecting sales proceeds as well as holding costs (such as taxes and insurance) over the period of the hypothetical liquidation and then discounting the value of such elements back to the taking date by an appropriate discount factor. Such a methodology was used with the consent of the parties in the New Haven litigation. *See supra* note 21. There is a split among railroad appraisers as to the appropriateness and feasibility of this practice; but the Special Court adopted it below. Regardless of whether this was permissible in determining the Section 306 standard of "net liquidation value", CNJ contends it was improper to do so in determining the constitutional issue of just compensation because holding costs, difficulties of sale, and the potential delays in receipt of proceeds were all taken into account by the appraisers in providing the opinions as to the fair market value of the separate parcels which was the beginning point of the valuation process. In effect, superimposing the discount methodology upon the appraisal process involved a double counting of the detriments of the property and thereby improperly reduced its net value to the extent of the double count.

The modeling of the results of the hypothetical scrapping process is not an uncommon exercise in the railroad business and leads to one measure of value to be considered with others in arriving at a fair valuation of railroad assets. It is, however, exceedingly uncommon to adopt a scrap valuation standard in determining the just compensation for assets taken for continued

use. Neither the Special Court nor, as it noted, the government parties, were able to find a single case in which such a measure has ever before been held to be constitutionally sufficient. The authorities and commentators have been uniformly of the belief that it is not.[28] The case of *In re Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968), which required a substantial payment for the public acquisition of tunnels with a negative scrap value, has previously been referred to by this Court as an appropriate instance of recognizing the condemnee's entitlement to the highest and best use of its property. *New Haven Inclusion*

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28. *See*, in the area of utilities valuation: *City of Denver* v. *Denver Union Water Co.*, 246 U.S. 178 (1918); *In re City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966), *appeal dismissed sub nom. Fifth Avenue Coach Lines, Inc.* v. *City of New York*, 386 U.S. 778 (1967); *In the Matter of Penn Central Transportation Co.*, 372 F. Supp. 1123 (E.D. Pa. 1974); *Trustees of Boston & Maine Corp.* v. *Massachusetts Bay Transp. Authority*, 294 N.E.2d 340 (Mass. 1973); *In re Aldercroft Heights City Water Dis.*, 60 P.U.R.3d 227 (Cal. Pub. Util. Comm'n 1965); *In re Fair Oaks Irrigation District*, P.U.R. 1918C, 879 (Cal. R.R. Comm'n 1918); *In re City of Washburn*, P.U.R. 1924D, 368 (Wis. R.R. Comm'n 1924); *In re City of Eureka*, 19 Cal. R.C.D. 952 (1922); *International Railway Co.* v. *Niagara Parks Commission*, 3 D.L.R. 305 (P.C. 1937); *In re Ottawa and Glouchester Road Co. and County of Carleton*, 69 D.L.R. 486 (Ont. Sup. Ct., App. Div. 1921); *see also* the additional cases cited and discussion in R.L. Hale, *Value to the Taker in Condemnation Cases*, 31 Colum. L. Rev. 1 (1931); Comment, *Valuing an Unprofitable Business Taken for Continuing Public Use*, 68 Colum. L. Rev. 977 (1968); Note, *Going Concern Value in Condemnation of Unprofitable Public Utilities*, 52 Cornell L.Q. 752 (1967); 2 Orgel, *Valuation Under Eminent Domain* § 217 (2d ed. 1953); *see also* the patent condemnation cases such as *Olsson* v. *United States*, 25 F. Supp. 495 (Ct. Cl. 1938), *cert. denied*, 307 U.S. 621 (1939); *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *rev'd in part on other grounds*, 320 U.S. 1 (1943); *Badowski* v. *United States*, 278 F.2d 934 (Ct. Cl. 1960); *Saulnier* v. *United States*, 314 F.2d 950 (Ct. Cl. 1963); *Ushakoff* v. *United States*, 375 F.2d 822 (Ct. Cl. 1967); *Tektronix Inc.* v. *United States*, 552 F.2d 343 (Ct. Cl. 1977), *cert. denied*, 439 U.S. 1048 (1978) and *see also* the wartime takings cases, *United States* v. *Buxton Lines, Inc.*, 165 F.2d 993 (4th Cir. 1948); *Swiss Federal Railways v. United States*, 112 F. Supp. 357 (Ct. Cl. 1953); *Wilson Athletic Goods Mfg. Co.* v. *United States*, 161 F.2d 915 (7th Cir. 1947).

Cases, 399 U.S. at 451-58[29]. The determination of the Special Court below presents a radical departure in the law. It is wrong as a matter of principle; and it results in a standard which unjustly tilts the balance between the government and private rights in favor of the government.

Nor can the Special Court's result be justified upon the theory that the scrap value model it created reflects the market value of the properties. A market value inquiry is a search for *what was in fact obtainable* for the properties in the appropriate market and not an occasion to superimpose upon real world judgments the normative opinions of a court as to *what should be obtainable* under hypothetical circumstances that have never existed. The Special Court has awarded the latter, not the former.

The Special Court did not award the market value of CNJ's transferred assets, *i.e.*, what a willing buyer would pay a willing seller if neither were under any compulsion to buy or sell. It was presented with extensive evidence of the State of New Jersey's 1974 purchase negotiations with the CNJ (consisting of contemporaneous documents and the testimony of the many persons involved in the negotiations) as well as of the State's perceptions of the scrap value of the transferred assets (consisting of its three extensive studies, *see supra* p. 6). It rejected this evidence (without ever observing the demeanor of a single witness) under improper standards of proof; finding that "it is *far from certain* that the State would have actually carried out such a project", *Rail Use Opinion*, 531 F. Supp. at 1377 (CA-575) and that CNJ

29. As the *New Haven* case recognizes, it is no answer to say that such use can be disregarded because it is unprofitable in the hands of its present owner. An industrial plant may be operating at a loss for many reasons having nothing to do with the suitability of the property for industrial use. Such a plant still has value as an industrial property in the market place so long as demand exists for such use. There is no doubt that the services provided by the CNJ system were not only in demand but regarded as essential, *see supra* p. 4, and under its present owner these and other formerly unprofitable rail operations have become highly profitable. The Special Court's focus on the circumstances, or more accurately the hypothetical circumstances, of the property owner led to an idiosyncratic valuation having little relation to the values transferred or the highest and best use of the property.

had not met "its burden of proof by *clear and convincing evidence*", *CNJ Opinion*, 571 F. Supp. at 1284 (CA-690) that New Jersey would have made an offer at any ascertainable figure. It determined that "for one reason, or another the minds of all concerned in 1974 were attuned to a higher scale", *id.* (CA-689) and concluded to measure CNJ's constitutional entitlement by substituting for this real world evidence its own version of a forced sale, scrap model formulated under the hypothetical, *a priori* assumption that all transferors would be seeking to dispose of their properties at the same time.[30]

The scrap valuations found by the Special Court do not reflect the market values of the transferred assets in a sale for scrap on the taking date. In fact, they do not reflect the scrap values that have ever prevailed on any date in the real world. On April 1, 1976, the date of the taking, there were real markets in which the assets transferred could have been sold on a dismantled basis and those markets included within them the potential availability of over 3000 miles of line which the Final System Plan prepared by USRA pursuant to the Rail Act concluded to leave with the estates, leaving them to obtain their value by alternative dispositions for scrap or otherwise. CNJ's evidence on scrap values priced the transferred assets in those real world markets which reflected the significant increases in potential supply created by the Rail Act. The Court rejected reference to those real markets in fashioning its own scrap model, pricing the assets in markets hypothetically glutted by even more of the assets of the other transferors.[31] In treating the assets of the other condemnees as

30. The scrap model fashioned by the Court in the *CNJ Opinion* differs widely not only in result but in methodology from the various studies available to the State in 1974. *See supra* p. 6. The wide variance in methodology demonstrates that the Court's results do not even purport to reflect how the State, or CNJ, actually viewed the scrap value of the properties. (These studies, which are in the record below, are lengthy; pertinent portions will be submitted with the brief on the merits if plenary consideration is granted to these appeals.)

31. One of the evils of the methodology adopted by the Court—*i.e.*, converting a factual inquiry as to market values into a normative judicial model under hypothetical assumptions—is that literally anything could be "found" which would support any pre-determined end result and be difficult to review. We will argue on appeal that, in addition to

part of the relevant market, the Court may have infringed upon the controlling principles of *Almota Farmers E. & W. Co. v. United States*, 409 U.S. 470 (1973); and it substituted speculative valuation conclusions, often unsupported by any proofs, for the valuations derived from real world market data. The Special Court's scrap model, having failed to measure the fair market values prevailing at the time of the taking realizable from a scrapping process, cannot be a proper measure of just compensation even if scrap values were the controlling standard.

Nor does the Special Court's scrap value result reflect the fair market value of the rail assets for continued rail use. There was no evidence that the Trustee or the estate would have been a willing seller at the prices found by the Court. There was no evidence that the State (or even any scrap dealer) viewed the property as having so little scrap value or that Commissioner Sagner ever sought to purchase it at such a low price. Instead the evidence is, as the Court found, that "the minds of all concerned [the negotiators and the many valuation experts who had valued the property] were attuned to a higher scale". *CNJ Opinion*, 571 F. Supp. at 1284 (CA-689). All the evidence as to what had actually occurred suggests that the property would have sold for at least twice the Special Court's valuation.

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the flaws noted in the text, the model created by the Court arbitrarily (a) rejected CNJ's real estate appraisal evidence under a clearly erroneous view of certain appraisal assumptions concerning rail service and topography in favor of preliminary, incomplete, penciled notations on prior appraisal worksheets (which utilized the same assumptions as CNJ's rejected appraisal evidence in the areas faulted by the Court) prepared for different and inapplicable purposes, which were then adjusted by the Court, (b) rejected 1976 equipment valuations of appraisers of both parties in favor of a lower 1968 study, (c) rejected 1976 assessments of appraisers of both parties as to the value of ties in favor of an erroneous inapplicable opinion reached by a former employee of one of CNJ's appraisers, (d) rejected substantial evidence of the marketability of light rail in favor of an unsubstantiated contrary opinion, and (e) applied and adjusted the basic concepts of a liquidation organization formulated for a 1968 appraisal which the appraiser involved demonstrated had no applicability to the circumstances posed by the valuation proceeding.

The Special Court brought to the valuation case a preconceived view which underestimated the value of the assets of the Northeastern railroads, for it had stated in its 1974 opinion in *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 917 "the idea that billions of dollars in liquidation proceeds of these bankrupt railroads are lurking just around the corner is unrealistic in the last degree." This view was uninformed, when formulated; and it infected the subsequent valuation proceedings that followed. We seek the opportunity to demonstrate at plenary hearing that the hypothetical scrap valuations derived from the court's judicial model do not measure the market value of the assets taken from CNJ or the just compensation to which CNJ is entitled.

B. THE QUESTIONS OF THE FORM OF COMPENSATION AND DELAY DAMAGES

The Special Court held that the certificates of value authorized by Section 306 of the Rail Act were a constitutionally sufficient form of consideration for the assets taken and adequately compensated for the delay damages CNJ has incurred since 1976 and may incur until December 31, 1987 when the certificates must be redeemed.[32] It held in the CMV opinion that the constitution does not require payment in cash for a taking, *CMV Opinion*, 445 F. Supp. at 1003-04 (CA-176). A number of other courts have held to the contrary. *See, Vanhorne's Lessee* v. *Dorrance*, 2 Dall. 304 (Cir. Ct. Pa. Dist. 1795); *Butler* v. *Sewer Commissioners*, 39 N.J.L. 665 (N.J. Sup. Ct. 1877); *Commonwealth* v. *Peters*, 2 Mass. 125 (1806); *Reynolds* v. *State Board of Public Roads*, 59 R.I. 120, 194 A. 535 (1937); *cf. State* v. *Dunclick, Inc.*, 77 Idaho 45, 286 P.2d 1112 (1955); *Connecticut River R.R.* v. *Franklin County Comm'r*, 127 Mass. 50 (1879); *Hamilton* v. *Annapolis, etc., R. Company*, 1 Johnson 107, (Md. Ch. 1847), *aff'd*, 1 Md. 553 (1852); *Bloodgood* v. *M. & H. R.R. Co.*, 18 Wend. 1 (N.Y.

32. The Court assumed that the certificates of value would be redeemed at an earlier point *Severance/Delay Damage Opinion*, slip op. at n.8 (CA-829, 857-58), but the government is not obliged to do so and has never stated that it would.

Ct. Err. 1837). This Court specifically reserved the question in the *Rail Act Cases*, 419 U.S. at 51-52.

Whether it is constitutionally permissible to use government obligations as just compensation is interwined in the present matter with the question of the sufficiency of the interest rate provided for the certificate of value in Section 306. Government obligations bearing 8% interest with early 1988 maturities are presently trading at a large discount with the consequence that the certificates of value issued to CNJ are worth considerably less than the amount it is entitled to receive. It is hard to see how this satisfies the requirement of the Fifth Amendment that the owner receive "a full and perfect equivalent for the property taken . . ." *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 326 (1893). The problem with the 8% interest rate, however, goes much further; for it emphasizes the inadequacy of the compensation to cover CNJ's delay damages.

It is well settled that, where there is a delay between the time of a public taking of private assets and the time of the payment therefor, the condemnee is entitled to have included within the just compensation that is paid an amount sufficient to compensate for the losses incurred during the period of the delay. *Seaboard Air Line Ry* v. *U.S.*, 261 U.S. 299, 306 (1923); *Kirby Forest Industries, Inc.* v. *U.S.*, ____ U.S. ____, 52 U.S.L.W. 4607, 4610 (U.S. May 21, 1984). The condemnee is entitled to receive the value of the condemned assets on the date of their taking; and it is the deprivation of this value, and the earnings that could have been generated from its investment and reinvestment, that constitutes the condemnee's loss. *Id.* at 4610.

It was also well settled that the rates of return on investments in conservative debt instruments available in the marketplace during the period of delay is an appropriate measure of the delay damages, although the lower courts have disagreed as to the type of investments to consider. The Court of Claims and other courts have used as a measurement the average annual rates during the delay period on long term corporate bonds rated Aaa. *See, e.g., Pitcairn* v. *U.S.*, 547 F.2d 1106 (Ct. Cl. 1976), *cert. denied*, 434

U.S. 1051 (1978); *Miller* v. *U.S.*, 620 F.2d 812 (Ct. Cl. 1980); *U.S.* v. *97.19 Acres*, 511 F. Supp. 565 (D. Md. 1981). Some federal courts have used other measurements, such as a mixture of government, bank and commercial debt obligations, averaging rates on this composite during the period involved. *See, e.g., U.S.* v. *429.59 Acres of Land*, 612 F.2d 459 (9th Cir. 1980). Others have used yields on U.S. Government obligations of varying duration. *See, e.g., U.S.* v. *5.00 Acres*, 507 F. Supp. 589 (E.D. Tex. 1981), *rev'd on other grounds*, 680 F.2d 388 (5th Cir. 1982), *rev'd on other grounds*, 731 F.2d 1207 (5th Cir. 1984); *United States* v. *8.41 Acres of Land*, 576 F. Supp. 685 (E.D. Tex. 1983). Very little judicial attention has been devoted to whether compounding of the returns selected is constitutionally required; and those who have considered the question have differed. Compare *U.S.* v. *429.59 Acres of Land*, 612 F.2d 459 (9th Cir. 1980); *U.S.* v. *319.46 Acres of Land*, 508 F. Supp. 288 (W.D. Okla. 1981) with *Georgia-Pacific Corp.* v. *U.S.*, 640 F.2d 328 (Ct. Cl. 1980); *U.S.* v. *97.19 Acres*, 511 F. Supp. 565 (D. Md. 1981). This Court has yet to pass on any of these issues.

In the instant matter the Special Court held that the 8% compound rate provided by the Rail Act was adequate and rejected the higher rates, which at times were more than twice the statutory rate, available during the delay period on virtually all types of conservative investments.

The Special Court deferred to the statutory rate because it was in line with interest rates which prevailed at the time of the taking. *Severance/Delay Damage Opinion*, slip op. at 18-19 (CA-829). Finding the statutory rate "reasonable at the time", the Court below ruled that it would not be "set aside." *Id.* Congress itself, however, recognized the possible inadequacy of the Section 306(c)(4) compensation and provided in Section 303(c) for an upward adjustment by the Special Court if necessary to meet constitutional minimum values. The over deference of the Court below to the statutory rate not only gives inadequate weight to this statutory consideration but also slights the basic

principle that the determination of what constitutes "just compensation" under the Fifth Amendment is exclusively a matter for the courts and not the legislature. *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 327 (1893); *Miller* v. *U.S.*, 620 F.2d 812, 837 (Ct. Cl. 1980); *U.S.* v. *Blankinship*, 543 F.2d 1272 (9th Cir. 1976).[33]

The Special Court sought to justify its deference to the 8% statutory rate by viewing it as the approximate equivalent of what it considered would have been the appropriate measurement in any event—namely, the yield on a long term U.S. Government bond issued and purchased in April of 1976 and maturing at the end of 1987 which it held, would approximate the certificates of value authorized by Section 306, both in terms of interest rate and maturity. This prospective assessment of appropriate delay damages based on a single hypothetical investment made at the time of the taking ignores the basic theory of delay damages, i.e., to compensate the condemnee for the damages *actually* incurred during the period of delay, whether or not contemplated at the time of the taking. The Special Court's decision to apply the interest rates prevailing at the time of the taking in disregard of all measurements which would reflect the much higher interest rates prevailing during the delay period conflicts with most, if not nearly all, of the lower federal court rulings in recent years. *See Miller* v. *U.S.*, 620 F.2d 812, 838 (Ct. Cl. 1980) and cases cited therein. It does not and cannot effectuate the basic objective to place the condemnee in "as good a position pecuniarily" as he could have been had he gotten his money at the time of the taking. *Kirby Forest Industries, Inc.*, 52 U.S.L.W. at 4610.

CNJ, if it had been paid in cash in 1976, of course, would not have been restricted to investing in Government securities, let alone those with 11 year maturities. It would have been free to invest and reinvest with the view to realizing the highest yield or

33. Moreover, the Court's deference to the legislative determination ignored the fact that the Congress set the rate at a time when the compensation included the Conrail securities and the certificates were not expected to be the sole or even major consideration paid for the conveyed properties. H.R. Rep. No. 781, 94th Cong., 2d sess. 199 *reprinted in* 1976 U.S. Code Cong. & Ad. News 214.

yields obtainable; and the proofs showed that, exercising reasonable prudence as to the safety of principal and interest, it could have, and actually did, on its own available funds, realize yields on conservative investments during the period in question well in excess of those realizable from an 11 year Government obligation bought in 1976. This is significant—not because CNJ has, in fact, realized such yields—but rather because such yields were generally obtainable and, thus, provide an objective measure of the delay damage element of just compensation. The questions posed by the ruling below are substantial, affecting both federal and state condemnations; for the "just compensation" requirement of the Fifth Amendment for federal takings applies also to state condemnations by virtue of the Fourteenth Amendment. *Webb's Fabulous Pharmacy, Inc.* v. *Beckwith*, 449 U.S. 155, 160 (1980); *Texaco, Inc.* v. *Short*, 454 U.S. 516, 522 (1982). The opinion should be reviewed on plenary hearing.

C. THE QUESTION OF SEVERANCE DAMAGES

Pursuant to the Rail Act, the Government took nearly all of CNJ's operating rail system but excluded CNJ's Newark Bay Bridge which was an integral part of that system. With its withdrawal from rail service, the bridge was rendered essentially useless, and its value to CNJ converted to a liability, as the U.S. Coast Guard, which had viewed the bridge as a hazard to navigation, began proceedings under the Bridge Act of 1906, 33 U.S.C. § 491 *et seq.* to require its removal.

As a result of the partial taking, CNJ was left with ownership of the now useless, severed bridge and liability for the entire cost of removal, then estimated at approximately $14,000,000.[34] The overall effect upon the condemnation proceeds was potentially to reduce the Special Court's finding of approximately $42,500,000

34. While the bridge was in rail service, any required alteration or removal would have been governed by the Truman-Hobbs Act, 33 U.S.C. § 502, and the cost thereof would have had to be borne by the Government except for expenditures found of benefit to the railroad. As the Special Court noted, under Truman-Hobbs the United States would have had to bear most if not all of the cost of removal of the CNJ bridge. *Severance/Delay Damage Opinion*, slip op. at 29 (CA-838).

for the value of CNJ's rail system at April 1, 1976, to approximately $28,500,000. CNJ seeks as severance damage reimbursement for the costs it has been obligated to bear as a result of the partial taking. The Court ignored the simple fact of the change in CNJ's actual circumstances from the owner of an operating rail system, including the bridge, to the owner of an isolated unused structure which resulted from the partial taking, exposed to huge liability for the cost of its removal. Instead, the Special Court concluded that the claim did not fall within the rubric of severance damages and proffered the thesis that the CNJ bridge had really lost its value for rail use because Conrail had taken another bridge (the Penn Central-Lehigh Valley Bridge to the north) for its traffic and that CNJ's injury, therefore, did not result from the partial taking of CNJ's property. The question, however, is not why the bridge was not needed by the condemnor but what made the bridge useless to CNJ. Clearly the answer to that lies in the severance of the balance of CNJ's rail system pursuant to the statutory taking.

The Court offered an alternative ground for rejecting CNJ's severance claim, finding that CNJ would have borne the removal costs in the absence of the Act because it was seeking, or would have sought, to liquidate its assets if the Act had not rescued it from its predicament or because the State in an asset purchase would have insisted upon either not acquiring the bridge or a $14 million deduction in its purchase price if the bridge were included in the rail assets purchased. The findings flow from the *a priori* liquidation assumptions of the Special Court, are inconsistent with prior findings by the Court,[35] and stand the events that actually occurred in the real world on their head. The record establishes that prior to the passage of the Act, the trustee never sought to cease rail operations or to liquidate; that he successfully resisted efforts of others before the Reorganization Court to compel such cessation; that the Third Circuit found that the estate's progress precluded the cessation of deficit passenger operations;

35. *See*, for example, footnote 6 *supra* and the Court's prior determinations as to the assets which the State would have acquired. *Rail Use Opinion*, 531 F. Supp. at 1209, 1379 (CA-291-92, 577-79).

that the estate literally begged Congress not to pass the Act and the Special Court not to compel CNJ's reorganization under it; that on the issue of erosion, CNJ stipulated that its CUE was zero instead of asserting any maturation of a so called "Brooks-Scanlon" right;[36] that all of the purchase negotiations with the State proceeded upon the assumption that the Bridge would be included within the purchase without significant offset in the purchase price;[37] and that the decision in *In re Port Authority Trans-Hudson Corporation*, 20 N.Y.2d 457, 231 N.E. 2d 734, 285 N.Y.S. 2d 24, *cert. denied*, 390 U.S. 1002 (1968), would have precluded the State from compelling any major offset.

The implementation of the Rail Act has saddled CNJ with a major financial responsibility it would not have otherwise faced. We seek the opportunity upon appeal to demonstrate fully the foregoing and to establish that the claim that has been asserted should, as a matter of constitutional principle, be cognizable as severance damages.

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36. *In the Matter of Penn Central Transportation Co.*, 384 F. Supp. at 918-19. CNJ's legal position was that the question of whether erosion exists turned on the values ultimately found for the conveyed assets. If those values were sufficient, there would be no erosion since potential interim losses from continued operations were counterbalanced by the assured minimum asset values and the probability of a value enhancing reorganization.

37. Not only was this the tenor of the negotiations; none of the valuation studies commissioned by the State contained any offsets of comparable magnitude.

CONCLUSION

For all of the foregoing reasons, this Court should note probable jurisdiction of these appeals.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.,
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

APPENDIX TO JURISDICTIONAL STATEMENT

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This Appendix is submitted by the Appellants, which consist of Central Jersey Industries, Inc. and its subsidiaries, The Central Railroad of Pennsylvania, the Communipaw Central Land Company, the Dover and Rockaway Railroad Co., the Mt. Hope Mineral Railroad Co., the Wharton and Northern Railroad Company and the Bayshore Connecting Railroad. There are no other subsidiaries or affiliates of any of the Appellants except for certain wholly owned subsidiaries of Central Jersey Industries, Inc.

APPENDIX A

Appendix A

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1976

Special Court—Misc. No. 76-1

Filed June 16, 1976, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT[1]

MEMORANDUM AND ORDER DIRECTING PRELIMINARY PROCEEDINGS FOR THE DETERMINATION OF GENERAL PRINCIPLES UNDER §§ 303 AND 306 OF THE ACT

I. HISTORICAL BACKGROUND AND GENERAL CONSIDERATIONS.

In this Court's opinion of September 30, 1974, 384 F. Supp. 895 at 926 n.53, we said that, as we then envisioned, our initial task after the conveyances provided in § 303 of the Act, "would be, after suitable briefing and argument, to set the principles for valuing the properties conveyed." These principles would then be applied to specific properties by a number of special masters, whose decisions we would review. It would have been premature to attempt to analyze just what issues would benefit from such advance determination, and we likewise did not address ourselves to such questions as whether an initial setting of guidelines would require discovery or the taking of evidence.

The extensive amendments made in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976 have considerably augmented the difficulties of what already was probably the most gigantic task ever confided to a court. The added

problems arise in considerable part from the Amendments' creation of a new form of security which is to comprise a part of the consideration payable to railroads that have transferred property to ConRail, namely, "certificates of value" (CV's), § 306, which are to be redeemed by USRA not later than December 31, 1987, § 306(c)(1); the CV's are guaranteed by the Secretary of Transportation, constitute general obligations of the United States, and carry the pledge of its full faith and credit, § 306(a). A separate series of CV's is to be issued to each transferor, § 306(b). Critical to ascertainment of the redemption price is our determination, § 306(c)(4), of the "base value" (BV) of each series. This is computed by determining the "net liquidation value" (NLV), to which the transferor may be entitled by virtue of transfer of property to ConRail, subtracting the value of other benefits provided under the Act (VOB), adding compensable unconstitutional erosion (CUE), and finally adding interest compounded annually at the rate of 8% per annum; to get the BV of each certificate, the figure just obtained is divided by the number of certificates in the series. The formula, omitting the interest item and the final division, thus is:

$$BV = NLV - VOB + CUE$$

A principal problem is that this new concept was superimposed on the concepts of "public interest," "fair and equitable," and "constitutional minimum" in § 303(c) without any clear indication in the statute itself, as distinguished from the legislative history, what Congress considered was the relationship of the securities issuable to the transferors[2] as prescribed by § 306 and the standards laid down in § 303.[3]

The added complexities created by the 1976 Amendments seemed to us to heighten the necessity for this Court to make as many determinations of law as possible, at least in a preliminary fashion, before putting the special masters to work. Putting aside for the moment the secondary debtors of Penn Central

(PC) and the non-bankrupt lessors, we have seven primary debtors, and it is apparent that more than one special master will be required in the case of Penn Central (PC) and perhaps in that of the Erie-Lackawanna (EL) if undue delay is to be avoided;[4] realistically therefore when we speak of special masters, we are thinking in terms of at least ten.

Because of such considerations the Court, on March 9, 1976, sent a letter to all members of the Acting Liaison Committee which the Court had appointed, outlining the Court's tentative views of what legal issues required decision and raising a number of procedural questions. This led in turn to the Court's order of April 26, 1976, prescribing a procedure whereby all parties were invited to file statements commenting on the issues and the structure of this proceeding, with an opportunity to file answers responding to the statements of others. The order also set forth a procedure whereby persons not named as parties might apply for leave to intervene. The Court has now reviewed these statements and answers, many of which have been exceedingly helpful.

While substantially all the comments recognize the existence of some questions which the Court may now determine after appropriate briefing and argument, most take a rather parsimonious view on this score. Although professing to recognize the necessity of providing the special masters with guidelines, many of the proposals seem to be that the special masters shall take evidence on whatever theory passing the lowest threshold of rationality may be offered to them.[5]

We think this would produce utter chaos. If a transferor or security holder[6] is allowed to offer evidence based on a certain theory of value, the Government parties[7] could not afford simply to argue that the theory was wrong; they would be obliged to cross-examine and offer rebuttal on the detailed application of the theory since for aught that would appear we might adopt it. Similarly the special masters would be obliged to make factual findings with respect to all theories even though we were to relieve

them of the task (which we would reserve for ourselves) of choosing among them.

While we respect the zeal displayed by the parties, there are other considerations that must be borne in mind. The PC has already been in reorganization for six years, the CNJ still longer, and the New Haven since 1961. It has now become apparent that a good many months will elapse before the special masters can profitably be put to work in any event. It is impossible to predict how long their labors will take under the best of circumstances, and if we had not already determined the proper principles we would be at the mercy of the slowest, since otherwise our determination in the earlier cases would govern the later ones without having afforded the parties in such cases a hearing. After the masters' reports will come our own consideration and decision on a mammoth record, and appeal to the Supreme Court, and possibly proceedings in the Court of Claims. Until all these steps, save perhaps the last, have been completed, the reorganization courts will be unable to make meaningful progress with their individual plans and the expensive administration of these estates, some of which are understood to be on the verge of actual insolvency, must continue. Indeed we have considerable doubt whether, under the procedures proposed by some parties, the CV's could be valued by December 31, 1987, their redemption date. The legal and other expenses of the litigation in this Court will be tremendous in any event and would become even more staggering and a legitimate subject for public concern if the litigation were protracted beyond the necessities of the case. Given all this and the fact that no procedure can produce a mathematically perfect result, it behooves all concerned with this proceeding to cooperate in devising procedures that will shorten the interval before final decision to the the full extent compatible with essential fairness. We believe it is possible to devise procedures that will enable us to decide a large number of basic questions before the special masters go to work, although there are other matters on which there is no need for an early decision. In

saying this we are conscious of the risk that by making some preliminary rulings we may be courting reversal by the Supreme Court and the need of starting all over again; we simply think the danger of this to be less serious than the consequences of letting the special masters proceed as some of the parties have proposed, see fn. 5. Indeed, as this Memorandum progresses, the need for our making a considerable number of preliminary rulings will become even more evident.

We add one final prefatory note. The complexity of this case, as revealed by the statements submitted to us, has convinced us that the many preliminary issues that must be considered are best addressed in several separate units. What follows is a delineation of these units, with instructions to the parties and intervenors as to how they should proceed as to each. For the convenience of the parties we annex a schedule of the dates fixed for various steps in these preliminary proceedings.

II. Questions Which the Court can now Decide Without Presentation of Factual Material.

There appears to be almost complete agreement that the Court may now decide, without taking any evidence, what we characterized in our March 9, 1976 letter as the "first set" of § 303 issues; indeed, there appears to be a fair amount of agreement how we should decide them. Accordingly we shall set these and some other matters for briefing and argument in accordance with the schedule outlined below:

Initial briefs - August 23, 1976
Answering briefs - September 21, 1976

Time requests for oral argument shall be filed with the answering briefs. In this and all other cases dealt with in this Memorandum and Order, the parties shall arrange for joint briefing and argument to the maximum extent possible and shall keep the length of

briefs to the minimum. After studying the briefs and time requests, the Court — perhaps after a pre-argument conference — will advise the parties of the time, place and organization of the argument.

In light of the statements, we deem it desirable to sharpen the issues as follows:[8]

(1) *"Public interest."* The first question raised in our March 9 letter concerned the nature of our responsibility under § 303(c)(1)(A) to determine whether the transfers and conveyances "are in the public interest . . . ," especially in view of the description of judicial review in the second sentence of § 209(a) and the statement on p. 137 of the Conference Report of January 23, 1976. Several parties suggest that we need only determine that Congress had a rational basis for enacting the Rail Act and make no suggestion that it did not. If that is right, this issue can be regarded as substantially out of the case. However, two other views emerge from some of the statements.

One of these is that the "public interest" test requires us to pass on the viability of ConRail. At the moment we do not understand why we need to do this, just how we should go about it, or what we could do if we decided in the negative since a major reconveyance does not appear to be feasible. If any parties espouse this view, they should develop it in briefs.

The other such view is that although the "public interest" test may have little or no significance for the main body of the conveyances, it may require us to pass on the inclusion of certain peripheral properties or to decide whether, if the Act be regarded as a condemnation statute, certain properties were taken for something other than a public use.[9] It is hard to consider the question *in vacuo*. Any transferor or security holder allowed to intervene who asserts this position shall include in its brief illustrative statements of the properties in respect of which sum a claim is made and the supporting reasons; the answer of the Government parties need meet such claims only with respect to legal issues since

evidence would have to be taken if the Court were to decide there is need to pursue the matter further. In other words, what the Court needs is factual material sufficient to enable it to decide whether, if any such claims are made, they have sufficient legal merit to require further development of the facts.

(2) *Fair and equitable.* The second question propounded in the March 9 letter concerned the construction of the "fair and equitable" language in § 303(c)(1), especially in view of the facts (a) that if the consideration is "fairer and more equitable than is required as constitutional minimum," § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable.

Almost all, perhaps all, the statements seem to agree that the fair and equitable language serves no significant function in the determination of the value of any particular property, although several parties (including the Government parties) have suggested that this language may have a bearing on the allocation of ConRail's Series 3 Preferred and common stock. There is no need to rule on the latter suggestion now, since it will not be a matter for immediate consideration by the masters. Accordingly the Court will consider the "fair and equitable" issue to have been removed from the process of valuing the properties of individual estates or other transferors unless this is raised in the briefs to be filed as above indicated; any person taking such a position shall state with precision and not merely in conclusory terms how the "fair and equitable" test differs from the constitutional minimum test with respect to valuation in the context of the Act as it now stands.

The March 9 letter also raised the question whether the Court was bound to ascertain by what amount the consideration was less than fair and equitable and, by the same token, less than the constitutional minimum, even though the Court might have no effective way of remedying the defect. Further consideration had

led us to an affirmative answer even before receipt of the statements; several of these suggest this and none opposes. Accordingly there is no need to brief this issue.

We pass now to certain other questions of law which we believe the Court may now be able to decide, without taking evidence. These should be briefed and argued in accordance with the schedule set out on page [CA-5].

(3) *Reorganization vs. eminent domain statute.* Although not raised in the March 9 letter, a question lurking in the case is whether the standard of valuation[10] should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both. At the moment the Court does not perceive that it should be. Any parties taking a different view should include arguments on the score in their briefs. Some parties also intimate that there may be different procedural requirements if the Act is regarded as an exercise of eminent domain; any party taking this view should brief it.

(4) *Reckless or deliberate disregard.* We include this item in the list, although it may not fit the caption. In the last paragraph of the March 9 letter, we stated we would "like to be promptly advised whether USRA, the United States, ConRail, or any other party represented on LC (Liaison Committee) takes the position that the last sentence of § 209 (e)(1) has any application in proceedings under § 303(c)(1)(A) and (B) or 306 (c)(4)" since, if they did, the Court would desire to receive briefs and hear argument on the statutory and constitutional questions that would be raised. USRA has advised the Court that it does not take that position. Unless any party advances that position in its opening briefs, see p. [CA-5], the Court will consider that the taking of such a position with respect to proceedings under the cited sections is foreclosed.

(5) *Method of handling the valuation of property not owned by a primary debtor.* The discussions of valuation in the statements of the primary debtors and their security holders seem to assume, without detailed discussion, that the properties are first to be valued for each estate and that the total will then be distributed, in some way not clearly defined, as between the constituent transferors. This is an almost necessary consequence of the view, espoused by several primary debtors and their security holders, that the transferred property is to be valued as a going concern, and also conforms to what we understand to be the general practice in condemnation proceedings. The FSP, Vol. I, pp. 126, 145, shows separate values for each of the subsidiary debtors of Penn Central, and Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 gives a more detailed breakdown. The statements filed by the lessors seem to assume that they will receive the full value of their properties, without regard to the interest of the lessees; we have not been informed of the position of the latter. It may be that we have here a whole new set of issues which have thus far received relatively little thought.

The Court confesses it is somewhat baffled by the problem which bears, among other things, on the number and the duties of the masters to be appointed, and would welcome detailed proposals and briefing, even though it may be premature to attempt a definitive decision at this time. All parties desiring to express views on how this problem should be handled shall file briefs not later than August 23, 1976, answering briefs not later than September 21, 1976, and time requests for oral argument along with the answering briefs. The Court will then determine what further proceedings shall be had.

III. "Net Liquidation Value."

It is clear that, under § 306(c)(4), the Court is bound to determine the net liquidation value to which the transferors are

entitled by virtue of transfers of rail properties to ConRail under § 303(b)(1) as a step in determining the BV of the CV's, whether the value of the securities (including the CV's) issuable to the transferors is the same as or more or less than the Constitutional Minimum Value (CMV). The statements, however, reveal serious differences of opinion how this task should be performed.

A.

USRA's approach is summarized in FSP, Vol. I, pp. 124-26, and is stated in considerable detail in an Appendix, Vol. I, pp. 141-55. The essence of USRA's method is captured in the following paragraphs on p. 125:

> To resolve these and other issues, USRA postulated a "master liquidation plan" describing in detail an orderly process for the disposition of each estate's assets. The key assumption of the plan is that the estates would be required to sell substantial assets for continued rail use but that the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses. USRA assumed further that because of the valid requirements of common carrier regulations, the estates would operate under subsidies, if need be, and maintain their rail operations until 1979, at which time the orderly liquidation would begin. This subsidy period is also consistent with the self-interest of the estates in maintaining healthy price levels for their assets. USRA's plan also makes the favorable assumption that orderly cessation actually occurs and, therefore, prices are not adversely affected by the economic dislocations which would result if the actual service termination were abrupt and not orderly. The

> master liquidation plan also recognizes the physical requirement for preparing assets for sale and their effect on the timing of asset disposition.
>
> In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates to other railroads with the prices of such transfers computed as if the estates had actually been allowed to exercise their asserted right to liquidate by selling all of their assets for nonrail uses. The pricing under the assumption of total liquidation is based on supply and demand conditions which such a time-phased liquidation of rail assets into nonrail uses would produce. The pace of asset disposition is tied to the time required to accomplish a transition to alternate modes and to prepare assets for sale.

We have no doubt that this is one theory of determining net liquidation value that must be considered. However, as indicated in the March 9 letter, even if USRA's general theory were to be accepted, its calculations depend on a considerable number of assumptions which are open to contest.

We cite as examples, but without limitation, "[a]ssessments of the time and cost of preparing the assets for sale, and the expected time required to dispose of such assets once prepared for sale in light of supply and demand conditions" (p. 125); "[t]he overall economic environment within which these activities would occur" (p. 125); the method for arriving at the discount factors stated at p. 126; the details of the calculations as to when all necessary authority to sell rail properties would be obtained, pp. 145-46 (including the question whether, if certain transferors would have been obliged to shut down for lack of funds, any such authority would have had to be obtained); what was done in regard to properties that may be "rail properties" within the Act but are not in the sense that authority to sell would have to be obtained; and the assumptions with respect to the determination of the value of

rolling stock (pp. 146-48), facilities (pp. 148-49) and real estate (pp. 149-51).

In order to avoid wildly conflicting approaches by the masters appointed to deal with particular transferors, it seems essential that the Court, perhaps with the assistance of one or more Special Masters, should pass on the general validity of these assumptions, even though we recognize that any decision on this would simply establish something like a presumption which could be challenged by any transferor, e.g., by showing that it could have obtained authority to abandon at a date earlier than that hypothesized by USRA (or would not have required such authority because of lack of funds or for other reasons) or that it was a peculiarly favorable position to sell rail ties. The transferors insist that before anything can be done in the way of briefing, there must be extensive discovery of the details of USRA assumptions and the basis for them.

While we agree that some discovery is needed before there can be any effective briefing, we believe this should be in two stages. The first stage would be devoted to general questions such as those we have outlined. The second stage, which could go on while we were considering these general issues, would relate to more specific matters, e.g., the correctness of the count of rolling stock, track, etc., or the validity of the choices of other real estate sales selected to determine market value.

USRA has now taken an important first step by serving on the parties copies of its Master Liquidation Plan and of five valuation reports. While we do not anticipate that these will satisfy transferors even with respect to first stage discovery, this submission should suffice to enable them to formulate requests, which can then form the subject of consideration by the Acting Liaison Committee, substantially as proposed in the June 7, 1976 response of the Government parties, pp. 13-15. We direct the parties and the Acting Liaison Committee to proceed along these lines with respect to what we have characterized as first stage discovery of NLV methodology used by USRA and by any of the

transferors and the Acting Liaison Committee to report to us no later than August 23, 1976.

B.

We now turn to another and more basic matter. The chief quarrel on the part of the transferors and security holders with USRA's general approach to the determination of NLV, summarized in the paragraph quoted from FSP. Vol. I, p. 125, as distinguished from the subsidiary assumptions leading to the final figures, and also as distinguished from the question whether CMV is higher than the value of the securities issuable to the transferors, relates to the second sentence. Many of the statements claim that, at least for certain properties, the maximum liquidation price would be attained by selling them for railroad use.[11]

We do not understand that the statements of the Government parties altogether dispute this, see pp. 12-17 of the opening statement and pp. 9-12 of the responsive statement. After outlining a formidable series of hurdles that, in their view, a transferor would have to overcome before he could establish that sale to another railroad would yield more than sales for non-rail use, and urging that on this account, "the Court should presume that no hypothetical combination of dispositions would have produced a value higher than that attainable in a disposition of all of the transferred properties for nonrail use," they concede that "[t]his presumption could be overcome by a showing by a transferor that . . . it could and would legally and feasibly have disposed of some or all of its properties, for rail use, at a value determined other than by reference to the value attainable in a liquidation for nonrail use," (p. 17).

The Government parties argue that before any transferor can be allowed even to attempt this showing, there must be a preliminary proceeding in which, as we understand it, all transferors

seeking to make the attempt must develop a consistent "alternative scenario" and the Court is to pass upon its feasibility, considered as a whole. While the presentation of such a plan would greatly facilitate our consideration, the Government parties have not indicated how we could compel this. At the moment we are not persuaded that the procedure proposed by the Government parties is necessary or even feasible. The subject can be more intelligently considered when we know what transferors intend to show more advantageous dispositions for rail use and with respect to what properties.

Before we request transferors to advance their proposals, there seems to be a point of law the decision of which will importantly affect the proceedings. Several transferors appear to include in their claim that NLV should take account of higher prices obtainable for rail than non-rail use not only sales of certain properties to solvent railroads (or other private groups if any such were possible purchasers) but also sales of other properties to public bodies vested with the power of condemnation. At the moment we do not understand why in the absence of competing private purchasers, such public bodies could be expected to pay more than the NLV for nonrail use.[12] We think this question can be usefully briefed, argued and decided along with those enumerated in Part II, Items (1), (2) and (3). The question is this:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in

the absence of proof of a private purchaser ready and willing to make the purchase?

Once the Court answers this question, the next step would be to require the transferors to enumerate the possible transfers they desire to have considered. It may be that, as suggested by the PC Trustees (p. 23), the transferors will require the aid of discovery to assist them in doing this; the Government parties say that on this and other subjects discovery should be reciprocal. USRA could expedite matters if it would promptly make available to transferors any information which it has in regard to the interest (or lack of it) displayed by private parties in acquiring parts of the properties conveyed to ConRail, including the history of the aborted negotiations with the Chessie and the Southern; the transferors should similarly make available to the Government parties facts as to efforts made by them to effect such sales. The mechanics for this should be discussed in the Acting Liaison Committee and included in the report directed above. When the transferors have formulated their proposals, it may well be desirable to utilize the two-phase process suggested by the PC Trustees — a first phase in which the Court, perhaps aided by a Special Master, would determine the feasibility of the proposed transfers, and a second phase ascertaining the prices that would have been obtainable.

A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

IV. Other Problems in Arriving at the Base Value of the Certificates of Value.

Since the discussion in Part III has taken us a considerable distance into the problems of § 306(c)(4), it will be convenient to complete our discussion of that section before returning to § 303(c)(1).

We think it would be desirable to separate the determination of BV into its three component parts, NLV, VOB, and CUE. We take it that Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 broadly reflects the position of the Government parties as to NLV. Any further revisions to take account of additional designations, property sales, and the changed conveyance date should be made promptly.

USRA has outlined its theories as to the determination of VOB in FSP, Vol. I, pp. 128-34. However, the FSP says that it had been "impossible within the statutory deadlines to arrive at any final quantification as to all categories of 'other benefits' "; that the figures given are at least in part "estimates and approximations"; and that USRA's "analysis will continue as regards both the quantification of established categories and the possible identification and quantification of additional categories." Most of the transferors claim that there are no, or few, "other benefits"; they also say that the failure of FSP to trace how the general principles stated on pp. 128-33 were translated into the figures in Tables 2 and 3 makes it impossible for them to voice their objections intelligently.

We think there is merit in the latter point, at least to the extent that the argument would be more meaningful if more details were known. We therefore direct USRA to prepare and file a more detailed explanation and calculation of VOB, taking such account as it thinks warranted of the criticisms in the statements. The objective would be to provide a statement in sufficient detail that we could rule on the issues of principle (i.e, whether a particular

category did or did not constitute a benefit) on the basis of USRA's statement and opposing affidavits going into principle rather than detail and thereby eliminate, as to categories we might rule out, the need for further discovery or factual presentation. USRA is directed to file such a statement not later than December 1, 1976. Again we urge USRA to be as forthcoming as feasible in its statement; the more that is voluntarily disclosed, within the realm of reason, the better are the chances for our being able to issue instructions to the masters without unnecessary advance discovery and taking of evidence. We also take note of the contention of some transferors that the benefits, in whole or in certain categories, are negative, and the legal problem arising therefrom. We believe that, at the appropriate time, this also can be handled by briefs supplemented with illustrative factual material — not in the sense of determining precise figures but in that of deciding whether the contention that "negative benefits" should be added rather than subtracted, or the more modest proposal that a "negative benefit" in one category is to be offset against positive benefits in others, are legally sustainable.

Turning to CUE, it now appears to us that there are three sets of legal issues which can be determined without awaiting the completion of detailed studies on the subject; indeed a relatively early resolution of these issues is essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE.

Two of these issues concern the period of erosion claims. The statement of the Government parties takes the position, p. 28 n.19, that there can be no valid erosion claim for any period prior to enactment of the Rail Act — a position finding at least some support in our earlier opinion, 384 F. Supp. at 925. The transferors disagree. Secondly, some transferors take the position that there can be valid erosion claims for periods after the March 31, 1976 conveyance with respect to property not conveyed. The Government parties presumably disagree. The third concerns

the nature of the items qualifying as erosion claims. The statement of the PC Trustees (pp. 11-12) helpfully subdivides erosion into "financial erosion" and "physical erosion." The former would include the four items mentioned in our earlier opinion, 384 F. Supp. at 923, and possibly others of similar nature. Physical erosion is the deterioration of plant which may result in a lower NLV for the properties conveyed and lower realizable values for those not conveyed. We think the two issues of dates and the issue of the nature of the items qualifying for treatment as CUE can be resolved, or at least narrowed, as a matter of principle on the basis of factual submissions without the taking of detailed evidence since we would not anticipate serious conflict on the facts. We direct that all persons making claims of CUE shall file not later than October 13, 1976 detailed statements with supporting briefs which shall include the following:

(1) The date when they contend that valid erosion claims began. These should be supported by inclusion of petitions, reports and orders in the various reorganization courts and financial data that are claimed to be relevant.

(2) Any date later than March 31, 1976 to which they contend that erosion continued. The statements should give some idea of the nature and amount of any such post-conveyance erosion claims and shall present the legal theory contended to support them.

(3) The categories (and some approximation of the amounts) of erosion claims.

The Government parties shall answer not later than November 15, 1976, and the claimants may reply not later than December 7, 1976. The Court will then set a date for argument.[13]

V. Constitutional Minimum Value.

While, as mentioned in Part III of this Memorandum, Congress was of the opinion, Conference Report p. 199, that by providing for CV's it had assured the transferors of the constitutional minimum, that opinion is, of course, not conclusive. As also mentioned in Part III, we are presently of the view, while this is subject to change after brief and argument, that when Congress spoke of liquidation, it meant liquidation, although liquidation is not necessarily sale exclusively for nonrail use. Unless further briefing and argument should alter the view stated in the preceding sentence, we would consider, as previously indicated, that many of the contentions with respect to an expansive notion of NLV should rather be regarded as contentions that even an application of NLV taking full account of possible dispositions for rail use may not produce values equal to the constitutional minimum.

It would seem that if a railroad (or a segment which would have been allowed to operate pruned of unprofitable extensions) has capitalized earning power in excess of NLV, even in the "world" where most of the rail service provided by the bankrupt estates has ceased, the Constitution would require payment on that basis. If the Government parties contest this proposition, or desire to frame conditions about it which they believe we should impose as guidelines to the masters, they should include a discussion of this in their opening briefs.[14]

Apart from this the statements and answers can be said generally to reveal the clash manifested by the majority and dissenting opinions in *In the Matter of the Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734 (1967). Putting the matter in another way, they raise the issue whether and, if so, how far the Supreme Court would consider that the situations here presented require a departure from the standard that in condemnation "the question is what has the owner lost, not what has the taker gained," *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910), and subsequent decisions. We see no

reason why we cannot formulate at least a general position on this subject without requiring the special masters to take detailed evidence on some or all of the many theories of valuation that would run afoul of the quoted standard if this is applicable. In saying this we do not mean to limit the parties to ordinary legal briefs. If any party believes it would be helpful to accompany its brief by affidavits or offers of proof, it may do so; the Court will consider these not as proof of the facts stated but for the light they shed on the legal issues. Such a course will meet the Supreme Court's comments in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 146 (1974), without requiring the vast expenditure of time and money that would follow from our leaving the issue of the constitutional minimum wholly at large until the masters have reported.

That issue, as we now see it, is whether the Constitution requires any valuation in excess of NLV properly defined, and as then used in § 306, plus any higher valuation of a railroad or segment derivable under the second paragraph of this Part V. Illustrative of the theories of valuation that would seem to fall if that question were to be answered in the negative are those propounded as theories of NLV in the statements of the Trustees of the Lehigh Valley, pp. 11, et seq.,[15] of the Erie Lackawanna, pp. 11, et seq.,[16] and of the Penn Central Trustees, pp. 9-11; those propounded as theories of the constitutional minimum in the statements of the Penn Central Lienholders, pp. 9, et seq.,[17] and the Committee of Secured Rail Creditors in the Penn Central Transportation Company Reorganization Proceedings;[18] the "true economic value" theory of the Penn Central Company; and the theory of the New Haven Trustee.[19] We emphasize that by mentioning the contentions of these parties as illustrations we are not relieving others who contend for a value higher than that formulated in the first sentence of this paragraph.[20]

There are three subsidiary issues that appear to require special briefing:

The first is this: Assuming that our answer to the question put above were to be generally in the negative, are there specific properties as to which valuation on the basis of NLV or a higher value based on capitalized earnings would be so manifestly unfair, because both factors work out at or near zero, that a higher value must be found and, if so, on what basis? This is essentially the question put by Judge Keating with respect to the Hudson River tunnel properties in *In the Matter of the Port Authority Trans-Hudson Corp., supra.* 20 N.Y.2d at 470, 231 N.E.2d at 739-40. While long tunnels of this sort are the paradigm, the transferors are invited to suggest other categories.

A second question, raised by the statement of the New Haven Trustee, is whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any higher basis than other properties.

A third issue, raised explicitly by the Lehigh Valley Trustee (pp. 23-24) but potentially of broad application, is whether the Constitution requires that compensation be given for any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise. Here again, we would expect those propounding this point to give sufficient examples to enable the Court to understand the nature of the claimed diminution, not necessarily in dollar amounts but by categories.

We recognize the possibility that, after the briefing and argument here directed, we may decide that some of the issues propounded in this Part V are not ripe for decision, or may determine to afford the Special Masters greater leeway (possibly in the form of permitting requests for further instructions) than we now contemplate. Nothing will have been lost, however, since the issues set forth in this Part V will have to be briefed and argued at some time in any event, and the benefit attainable from our ruling in 1977 rather than many years later, after prodigious efforts before and by the special masters, which may be unnecessary, is so tremendous.

Recognizing that the issues raised in this Part V are of great consequence and that factual materials may need to be assembled, we shall allow considerably more time for the filing of papers. We set the following schedules:

Presentation of proponents - January 6, 1977
Presentation of Government parties - February 20, 1977
Replies of proponents - March 18, 1977

We shall defer fixing a date for argument until the papers have been filed.

VI. Petitions for leave to intervene.

In view of the large number of parties entitled to participate in these proceedings as a right, the Court cannot be as liberal in granting interventions as it might like to be. Indeed in some ways the intervention of creditor and stockholder interests may be counterproductive; insofar as they merely repeat arguments already ably made by transferors, they diminish the force of the latter. Paraphrasing Mr. Justice Stewart's well-known remark in *New York Times Co.* v. *United States*, 403 U.S. 713, 729 (1971), when everyone is heard, no one is heard. We are also mindful of the considerations concerning expense mentioned in Part I of this Memorandum. We are therefore granting intervention in these proceedings for the establishment of general principles to intervenors who have demonstrated a legal interest in the outcome and have taken or propose to take positions different from that taken by the transferors. What interventions shall be granted in proceedings relating to the application of the general principles to specific properties can be determined later.

Applying this criterion we grant intervention in the proceedings provided for in this Memorandum and Order to the following:

Institutional Investors Penn Central Group and certain Penn Central Indenture Trustees.

The First National Bank of Chicago as Trustee under First Mortgage Indenture of the Chicago River and Indiana Railroad Company, for the limited purpose of presenting arguments pertaining specifically to the C.R. & I.

Provident National Bank and A. Wakelee Swartz, Jr., as Indenture Trustees for Pennsylvania Tunnel and Terminal Railroad Company, and the Bank of New Jersey, as Indenture Trustee for New York Connecting Railroad Co., for the limited purpose of presenting arguments pertaining specifically to the named railroads.

Citibank, N.A., as Agent for the Committee of Secured Bank Creditors in the Penn Central Transportation Company Reorganization Proceedings, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the theory of valuation discussed in its petition and accompanying statement.

Richard Joyce Smith, Trustee of the Property of the New York, New Haven & Hartford R.R. Co., for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central.

Penn Central Company, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the issues outlined in its petition and accompanying statement.

The following applications are denied for lack of a sufficiently specific showing of inadequacy of representation by other parties in the proceedings provided for in this Memorandum and Order and, in some instances, for failure to file a statement of contentions as required by this Court's order of April 26, 1976:

Appendix A

Joint Application of Morgan Guaranty Trust Company of New York and eight other indenture trustees of Erie Lackawanna Railway Company Joint Application of Girard Trust Bank and four other indenture trustees of Lehigh Valley Railway Company.

Petition of John W. Sullivan, John D. Mabie, and Thomas A. Reynolds, Jr., minority stockholders of Reading Company.

Petition of Minority Stockholders of Mahoning Coal Railroad Co.

Petitions for leave to intervene have been filed on behalf of five governmental bodies listed in the margin.[21] As to almost all of the questions set forth in this memorandum, we fail to see that these bodies have an interest justifying even permissive intervention; the only exception would be if a contention were to be made that some of the transfers were not in the public interest, see Part II (1). These petitions are denied without prejudice to applications for limited intervention in the event indicated.

This constitutes an order; the parties shall proceed in accordance herewith.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge /

June 16, 1976

Appendix A

FOOTNOTES

1. The Court has adopted a new caption and docket number for general matters relating to the valuation proceedings under §§ 303(c) and 306. All papers subsequently filed in general proceedings dealing with valuation shall bear this caption and docket number. The Court will enter an order transferring from Docket Misc. No. 75-3 matters relating to these general valuation proceedings and also breaking Misc. No. 75-3 into various categories.

2. We use the term "securities" to include other forms of consideration moving to a transferor.

3. The problems would have been less under the bill as passed by the Senate which used the phrase "constitutional minimum" instead of NLV.

4. The valuation of the New Haven took four years even though there was general agreement that the property should be valued primarily on a scrap value basis.

5. Thus the statement on behalf of Reading Company and its wholly-owned subsidiaries says (p. 13):

> Therefore, the only proper instructions that this Court can give the Special Masters is to hear all evidence pertaining to value each party desires to introduce and to structure the appropriate theory of valuation at the end of the proceeding.

6. We use this term to include indenture trustees.

7. For present purposes, we include ConRail along with the United States and USRA in the term "Government parties."

8. It should be clearly understood that any expressions in this Memorandum and Order which relate to the merits or to procedures not herein prescribed are designed solely to assist in structuring these proceedings and do not indicate a prejudgment.

9. Here, as elsewhere in this Memorandum, we will take it for granted that parties who wish to establish that a question that has been raised has constitutional as well as statutory dimensions will develop the point in their briefs.

10. We use this phrase so as to exclude for present purposes the question whether to the extent that the statute is an eminent domain

statute, as the non-bankrupt transferors claim it necessarily is as to them, and as some other parties claim as well, the Constitution requires that the consideration be paid in cash.

11. This contention is to be distinguished from the argument that for certain segments the "highest and best use" would be retention by the transferor for railroad purposes. This sounds rather on the claim that CMV may exceed the value of the securities issuable to the transferors, although a determination of capitalized earnings would have evidentiary value for both.

12. Except, of course, in a situation similar to that envisioned in fn. 5.

13. The Trustee of the Ann Arbor has raised an issue of law peculiar to it. Since this estate has conveyed no property to ConRail, it will not obtain CV's. The Trustee wishes us to decide whether we have power to enter a deficiency judgment for CUE under § 303(c)(3) and direct payment by the United States under § 303(c)(5). If we should decide in the negative, the Trustee would like to proceed directly in the Court of Claims. We think it preferable to defer decision on this at least until we have passed on the general questions with respect to erosion outlined above.

14. In our 1974 opinion, 384 F.Supp. at 923 n.51, we took note of a theory which we thought to be then suggested by the Government parties, namely, that the constitutional minimum might be less than liquidation value in the case of a railroad (or perhaps a segment) with earnings which were sufficient that it could not obtain permission to abandon but whose capitalized value was less than liquidation value. The Government parties do not now seem to urge this except for making the point that if ConRail has sufficiently large earnings, there may be no need for determining net liquidation value. If the Government parties wish to preserve the contention averted to in the cited footnote, they should also include an argument on this in their opening briefs.

15. Real estate at fair market value plus an assemblage factor:

Improvements at the higher of a scrap value or going concern value:

Going concern value measured by a combination of:

Capitalized prospective earnings

Public usefulness (the price of reconstruction or of a substitute facility)

RCNLD in appropriate instances

Value in place (i.e., scrap value with no subtraction for dismantling).

16. Capitalized earning power as basis for sale to another railroad:

Gross liquidation value (i.e., no cost for dismantling) as basis for sale to another railroad;

"Special Value" to a public body (e.g., a state) calculated by some combination of:

Depreciated value of track

Market value of land, plus assemblage factor

Gross liquidation value

Value of a developed operating organization

Value of not having to develop more costly alternatives

RCNLD of special facilities;

"Residual Value"—i.e., value as an integrated network.

17. Value properties as an assembled unit (i.e., apparently as a "going concern") by an appropriate combination of:

Land at fair market value plus assemblage;

Track at depreciated value;

Related facilities at cost plus appreciation;

Intangibles at cost of production less obsolescence;

For special facilities, RCNLD;

Value to public in terms of costs of alternatives.

18. "[W]hat it would have cost an acquiring entity on April 1, 1976 to buy, in an arm's length transaction, the conveyed real estate and to then build an integrated rail system . . . on that real estate . . . (p. 4)"

Appendix A

19. Presumption of reconstruction cost new less depreciation unless the Government parties rebut this.

20. We have not mentioned the contentions of the Government parties as to "ConRail use value" since we do not understand their precise relevance. If the Government parties wish these to be considered as part of the proceedings here contemplated, they should make a further submission on the subject not later than August 15, 1976.

21. The Commonwealth of Pennsylvania, the State of Delaware, the Department of Transportation of the State of New York, the Maryland Department of Transportation and the city of Philadelphia.

Appendix A

Schedule

Subject

(1) "Public interest"; "fair and equitable"; reorganization vs. eminent domain statutes, reckless or deliberate disregard clause, § 209(a)(1)—see Part II, Items (1), (2), (3) and (4); relevance of possibility of sale for rail use to public bodies having power of condemnation, see Part III.

Opening briefs—August 23
Answering briefs—September 21

(2) Method of handling the valuation of properties not owned by primary debtors, see Part II, Item (3).

Opening briefs—August 23
Answering briefs—September 21

(3) Report by Acting Liaison Committee with respect to first stage discovery on NLV methodology and on efforts by USRA and transferors to effect sales for rail use to private parties.

August 23

(4) Date on which USRA shall file detailed statement of value of other benefits.

December 1

(5) Filing by transferors of statements and briefs with respect to uncompensated unconstitutional erosion: October 13

Response by Government parties: November 15
Replies: December 7

(6) Briefs (accompanied by affidavits or offers of proof) on constitutional minimum.

Opening briefs—January 6
Answering briefs—February 20
Reply briefs—March 18

APPENDIX B

Appendix B

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

Filed October 18, 1976, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Opinion with Respect to Issues Set for Briefing and Argument as Subjects (1) and (2) of Schedule Attached to Memorandum and Order of June 16, 1976

FRIENDLY, Presiding Judge:

In our Memorandum and Order of June 16, 1976 (hereafter "June 16 Memorandum"), a copy of which is appended to this opinion as an addendum, issued after we had received statements of position from the parties and answers thereto, we sought to identify certain issues of principle early determination of which by this Court would enable us to frame appropriate instructions to the special masters who will take detailed evidence. Opening briefs on various subjects were due by August 23, with answering briefs to be filed on September 21. Oral argument was heard on September 27. In this opinion we deal with most of these subjects, although, as anticipated in the June 16 Memorandum, we find that an attempt at resolution of some would be premature.

Appendix B

I. "PUBLIC INTEREST"

Section 303(c)(1)(A) of the Rail Act directs that after the transfers and conveyances of the properties designated in the FSP, this Court "giving due consideration to the findings contained in the final system plan" shall determine, among other things, whether such transfers or conveyances "are in the public interest". We raised the question what our responsibilities in making that determination could be since a number of provisions of the Act and materials in the legislative history indicated that we were not to pass generally on the merits of the FSP from a transportation standpoint,[1] a task performed initially by USRA and later in some degree by Congress itself, and also because any large scale reconveyance would be impracticable.

Most of the parties, evidently sharing our inability to discern what Congress expected of us, have advanced no suggestions on this. The E-L Trustees suggest that the "public interest" clause might require us to consider the viability of ConRail at the time when it becomes necessary to distribute the Series B Preferred Stock and the common stock, whose fair market value is deductible from the base value of the certificates of value, § 306(c).[2] We are not greatly impressed by the argument but we need not deal with it at this time since the date of the distribution unhappily is far in the future.

The Trustees of the Reading suggest that the "public interest" requirement compels us to pass on contentions that the designations of certain property do not meet that criterion. They cite as examples the designation of Reading's 3,000 shares (all the capital stock) of the Washington & Franklin Railway Company, which is leased to the Western Maryland Railroad Company, a Chessie System subsidiary, under a 995-year lease running from July 1, 1901, and Reading's 500 shares of stock in the Trailer Train Company. The First National Bank of Chicago, as Trustee under the First Mortgage Indenture of The Chicago River and Indiana Railroad Company, raises a somewhat similar question

with respect to the Ashland Avenue year in Chicago.[3] Finally, the North Pennsylvania Railroad Company, the Delaware and Bound Brook Railroad Company, the Philadelphia, Germantown and Norristown Railroad Company, and the Plymouth Railroad Company, question whether two properties—one belonging to the Bound Brook and allegedly without rail use, and the other consisting of various overhead utility wire rental agreements—were properly designated.

Although we are cognizant of the arguments, based particularly on the final sentence of § 208(d)(2), on § 208(d)(3)(C), and on the final sentence of § 209(e)(1), that may be made against such review, we are not disposed to rule out the latter without further briefing. Contentions that particular transfers were not "in the public interest" raise some of the same questions as contentions, raised at an earlier stage of the proceedings before us, that certain designations were not of "rail properties" as defined in § 102(12). It is highly desirable that if any transfers or conveyances are to be annulled as not in the public interest or as unauthorized, this should be determined before time and effort are expended in valuing them. We therefore direct that any claims that transfers or conveyances were not in the public interest or were unauthorized be filed, in the form of complaints in separately numbered actions, not later than December 1, 1976, and order that any claims not so filed will be deemed to have been waived. Notice of this direction will be promptly mailed by the Court's executive attorney to counsel for all transferors who appeared in the transfer proceedings, Misc. No. 75-3. We, of course, encourage the parties to endeavor promptly to settle any disputes of this sort; an appendix to the answering brief of the Government parties indicates that such efforts are in progress with respect to several of the properties we have mentioned.

Save to the extent here indicated, we shall instruct the special masters not to give further consideration to the "public interest" criterion of § 303(c)(1)(A) insofar as it relates to setting a

standard of valuation unless a party makes a specific and supported request to that end, showing that a different result would ensue from application of the criterion, in which event the master shall seek this Court's further instructions.

II. "Fair and Equitable"

Section 303(c)(1)(A) also requires us to make a finding, subsequent to the transfers and conveyances, that these

> are fair and equitable to the estate of each railroad in reorganization in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under section 77 of the Bankruptcy Act (11 U.S.C. 205), or fair and equitable to a railroad that is not itself in reorganization but which is leased, operated, or controlled by a railroad in reorganization. . . .

In the June 16 Memorandum we expressed doubt whether these words, generally used in corporate reorganization law to deal with the distribution of the securities of a reorganized company among various classes of creditors and stockholders, had any practical application to the valuation of the properties "in view of the facts (a) that if the consideration is 'fairer and more equitable than is required as a constitutional minimum,' § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable."

Here again most of the parties share our inability to discern why, under the terms of the Rail Act, the requirement that we find that the consideration is more than, less than, or equal to the "constitutional minimum" does not drain the "fair and equitable" language of all meaning as regards the adequacy of the total consideration to be received by each transferor.[4] Accordingly we propose to instruct the special masters that in valuating the

properties they need not address themselves to the fair and equitable standard as distinguished from the constitutional minimum in the absence of a specific and supported claim that a different result would ensue from application of such a standard, in which event the master shall seek this Court's further instructions.

III. Reorganization vs. eminent domain statute

In the June 16 Memorandum we requested the parties to brief the question "whether the standard of valuation should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both." (P. 9, footnote omitted). The question how far the Rail Act is a "reorganization statute" and how far it is an exercise of eminent domain was considered by this Court in *In the Matter of Penn Central Transportation Company*, 384 F. Supp. 895, 926-38, 948-52 (1974) (sometimes hereafter "our 1974 decision"), and, more importantly, by the Supreme Court in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 148-55 (1974).

In light of the briefs and argument, we now have some doubt whether the question we put in our June 16 Memorandum was precisely the right one. Perhaps the question could be more accurately stated as being whether the Act involves a taking and, if so, whether the "constitutional minimum" required both by the terms of the Act and by the Fifth Amendment differs if the Act should be regarded as a reorganization statute enacted under the bankruptcy power or as a statute enacted under the commerce power or as both.

The transferors and creditor and stockholder interests argue that the Rail Act is a taking within such cases as *United States* v. *Causby*, 328 U.S. 256 (1946), and *Armstrong* v. *United States*, 364 U.S. 40 (1960), and that the constitutional minimum must, therefore, be a figure established in light of the body of case law relating to eminent domain, of which they regard the decision in *In the Matter of the Port Authority Trans-hudson Corp.*, 20

N.Y.2d 457, 231 N.E.2d 734 (1967), *cert. denied*, 390 U.S. 1002 (1968), as a significant example. They would dispose of the Supreme Court's indication, 419 U.S. at 155, that the only taking is of the "shortfall" between the constitutional minimum and the value of the compensation provided under the Act on the basis that this formulation requires judicial determination of what constitutes a constitutional minimum and that the process of determining the amount of any "shortfall" thus is no different than if the entire property were taken. In other words, they regard the Count's emphasis on the Act's being a valid exercise of the bankruptcy power and thus a reorganization statute, 419 U.S. at 153, as being a basis for upholding the validity of the Act without the Court's being obliged to decide whether compensation other than money may be adequate under what is solely a condemnation statute, see 419 U.S. at 149-55, rather than as implying that the constitutional minimum would be different than if the Rail Act had been enacted solely under the commerce power.

The Government parties point to other arguments which look the other way. They cite this court's statement, 384 F. Supp. at 927, that Congress did not have to choose between "the Scylla of outright condemnation and subsequent nationalization and the Charybdis of a collapse of rail transportation in the most heavily industrialized section of the country"; they argue from this that we did not believe that the Rail Act constituted "outright condemnation." They refer also to the Supreme Court's statement, 419 U.S. at 152-53, where in answer to a contention that the Rail Act's provisions "for a compelled conveyance and for the continuation of rail services pending formulation of the Final System Plan constitute the Act a condemnation statute", the Court found "no significance in these features of the Act" since "Congress, in enacting those provisions, clearly intended to legislate pursuant to the bankruptcy power", and followed this up with a reference to *RFC* v. *Denver & R.G.W.R. Co.*, 328 U.S. 495 (1946), "where the Court sustained the 'cram down' provision of § 77 authorizing a reorganization court to confirm a plan despite its rejection by

creditors." Stressing the creditors' and stockholders' continued ownership in the assets conveyed to ConRail by virtue of the distribution of the Series B Preferred and common stock to the transferors, the Government parties argue that if Congress had simply authorized or directed a reorganization court to carve out the most productive elements of a bankrupt railroad and transfer them to a new corporation in exchange for its securities, this would have come within traditional reorganization concepts and that no different result is required because the Rail Act dealt with the assets of a number of primary and secondary bankrupts and even of non-bankrupts whose properties were leased or controlled by bankrupts. See in this connection the discussion at 384 F. Supp. at 951-52. The upshot of the contention of the Government parties is that the constitutional minimum for the properties transferred should be determined solely by reference to the value of realistic choices of which the Rail Act deprived the transferors, rather than under principles of condemnation law if the latter should in fact be different, which they deny.

In light of our conclusion that determination both of net liquidation value and of the constitutional minimum requires consideration of evidence showing significant likelihood of sales for rail use, it is difficult at this point to appraise exactly how much may ride upon the difference between these views. It is clear, however, that the amount may be substantial. In the light of the extensive and helpful briefing and argument, it now appears to us that a decision as between the respective positions at this time might significantly impinge upon our determination of constitutional minimum value discussed in Part V of our June 16 Memorandum which we set for more detailed briefing in early 1977. Accordingly, we conclude that it is not desirable at this time to answer the question put in Part II(3) of our June 16 Memorandum, as put or as here recast, and that we should defer decision until we have received the briefs therein specified and heard further argument.

Appendix B

IV. Sales to public bodies for rail use—and herein of "net liquidation value."

On p. 16 of the June 16 Memorandum we posed the following question:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?

For the reasons indicated below, the submissions convince us that the transferors should be left free to develop the significant likelihood of such sales and the prices expectable therefrom, following the procedures outlined on pages 16 and 17 of our June 16 Memorandum.

The Government parties argue strenuously for a negative answer to the question posed. They rely heavily on the point that sale to a public body even for rail use would constitute an abandonment requiring a certificate from the Interstate Commerce Commission under § 1(18) of the Interstate Commerce Act; that § 1(20) authorizes the Commission to "attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require"; and that the Commission frequently includes as a condition a "salvage value clause." This typically reads:

> [T]he applicant [shall] sell the branch or any part thereof, to any person or persons offering . . . to purchase

> the same for continued operation at a price not less than the net salvage value thereof.

Texas & N.O. R.R. Abandonment, 282 I.C.C 1, 13 (1951). See also *Jamestown, W. & N. R.R. Abandonment*, 217 I.C.C. 739, 740 (1937); more recent cases cited in *New haven Inclusion Cases*, 399 U.S. 332, 472 n.74 (1970); C. Cherington, The Regulation of Railroad Abandonments 172 n.42 (1948). The Government argues that, having fair assurance that the Commission would include such a clause, no rational purchaser, public or otherwise, would pay more than salvage value unless required to do so by the threat of a higher competitive bid.

Although we do not preclude the Government parties from further argument on this point, we are not much persuaded. The purpose of such clauses is, as stated *in Tennessee Central Ry. Abandonment*, 333 I.C.C. 443, 455 (1968), to insure that an applicant for abandonment "give first consideration to any offer for acquisition which contemplates continued operations over all or substantially all of its line railroad." The Commission's specification of salvage value has occurred in contexts in which the owner was proposing to scrap the branch and had no better alternative in view. It is the continued operation, not preventing an owner from securing an optimum price, which is the Commission's prime objective. As the Commission stated in *Washington and Old Dominion Railroad Abandonment*, 331 I.C.C. 587,599-600 (1968), review action dismissed without need to discuss the point, *Washington and Old Dominion Users Ass'n v. United States*, 287 F. Supp. 528 (E.D. Va. 1968),

> Ordinarily the prescription of a price in the terms "not less than net salvage value" sets only the bidding minimum and guarantees that the abandoning railroad will not have to take less in a sale of the line intact for future operations than it could obtain by disposal otherwise. What price is

> actually paid depends, in most instances, upon circumstances, peculiar to each case—though not less than net salvage value. It might be the highest price bid above scrap value; or a price stated by the carrier as satisfactory to it; or some amount above a stated salvage value; or a price negotiated at arms length by the abandoning line and the acquirer.

Although this was said in a case where the proposed disposition at a figure higher than salvage value was for highway rather than railroad use, the Commission has also refused to use the salvage clause as a means for limiting the amount which a railroad seller may obtain from a railroad purchaser. *Chicago, M., St.P. & P. R.R. Abandonment*, 347 I.C.C 1, 2 (1973). The Commission there said it was of the view:

> that in prior proceedings involving conditions such as that herein, the Commission has not undertaken to set the *maximum* price for the sale of such trackage [see, *Washington & Old Dominion R. Abandonment—Virginia*, 331 I.C.C. 587, 599 (1968)]; that it has been recognized, among other things, that to do so would be an unwarranted interference with the contractual rights of the parties; that setting a maximum price based solely on the net salvage value of the line might ignore other factors, such as the value of the right-of-way, having a reasonable bearing on a fair price for requiring continued operations of the line in the interest of the public; that in establishing the standard of net salvage value as a *minimum*, reasonable price, the Commission has been cognizant that a railroad should be able to recover at least this much of its capital investment in its line in exchange of foregoing the opportunity of selling the trackage for other than transportation purposes or for possible usage of the trackage in other parts of its system. . . .

The Government parties have pointed us to no case where the Commission insisted on sale at salvage value where a purchaser for continued use, even in the absence of competition, was willing to pay more, and we are by no means certain that the Commission lawfully could attach a salvage clause in such a situation, even if, as apparently is not the case, its policy were to do so. Insofar as a statement in *New York, N.H. & H. R.R. Bondholders' Committee* v. *United States*, 289 F. Supp. 418, 435 (S.D.N.Y. 1968), may indicate that the Commission could and would require a sale at salvage value where a public body would be compelled to pay more under a state condemnation statute, this was said in a case where there was no proof of interest by the public body in a consensual sale at a price above salvage value and without the court's having had the benefit of citation to the Commission decisions in the *Old Dominion* and *Milwaukee* cases, the latter of which had not yet been rendered.

Furthermore, it is not certain that all abandonments will have to await action by the Commission. In this Court's 1974 opinion, 384 F. Supp. at 919 n.31, we stated our assumption that abandonment procedures might have to be pretermitted if a reorganization trustee ran out of cash after exhausting all reasonable efforts to raise it. The answering brief of the CNJ Trustee (p. 11 n. 9) considers this to be only one instance of a general principle that a certificate of abandonment is not required when cessation of operations is compelled by circumstances beyond the railroad's control. See also reply brief of Penn Central Lienholders, p. 26. Since this question is also important on the issue of the timing of sales for scrap, we prefer not now to decide how far our assumption or the broader argument noted is sound; it suffices that the points are sufficiently arguable that we would not wish to decide them against the transferors at this time.

Finally, transferors and creditor interests have cited examples in which public bodies vested with the power of eminent domain have paid more than scrap value for railroad properties desired for continued use even in the absence of competition and have

given reasons why this behavior would not be irrational even if the arguments of the Government parties with respect to salvage clauses were sounder than we now think them to be. Among these are the desire for a speedy settlement to prevent further decreases or deterioration of service; the possibility that a certificate of abandonment might not be required; the desire to acquire not simply physical assets but an operating organization; fear that a reorganization court might not approve a sale at salvage value; and the fact that state condemnation statutes might require payment of more than scrap value so that a settlement may be cheaper as well as swifter than condemnation proceedings. For all these reasons we think that transferors and creditors should be free to develop realistic possibilities of sales of particular lies to public bodies at higher than scrap value even in the absence of proof of competition; the Government parties will, of course, be free to counter any such proof with any relevant evidence.[5] The Court calls attention to the procedure for handling the subject of sales for railroad use generally which is outlined on pages 16 and 17 of the June 16 Memorandum and urges that this process be expedited.

V. NET LIQUIDATION VALUE VERSUS CONSTITUTIONAL MINIMUM

On p. 17 of the June 16 Memorandum we stated:

> A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

Despite this, the brief of the New Haven Trustee[6] contains an extensive argument that NLV should be read as the equivalent of CMV. Although we shall abide by our commitment not to decide this issue until the briefing and argument of subject (6), we think that since the issue has been ventilated, it would assist the parties if we stated why, whatever the desiderata might be, we are unconvinced at the moment that a determination of net liquidation value embraces all the elements that may be called for in determining the constitutional minimum.

The Rail Act as adopted on January 2, 1974, 87 Stat. 985, did not require a determination of net liquidation value. Neither did the Senate version of the 1976 Act, S. 2718, 94th Cong., 1st Sess. The provision in the Senate bill for determining the base value of the certificates of value was that this "shall be the value obtained by taking the constitutional minimum value, if any (as determined pursuant to section 303(c)(1) of this title)," plus and minus certain items.

In passing the bill in this form the Senate overrode an objection from the Secretary of Transportation reading as follows:

> The base value of certificates of value should not be established at whatever figure the Special Court designates as the constitutional minimum. Such a provision will seem to signal a congressional repudiation of both USRA's net liquidation value theory and Congress' own intention in the Regional Rail Act to provide for a reorganization, not a condemnation, of the bankrupt railroads.

S. Rep. No. 499, 94th Cong., 1st Sess. 315-16 (1975). The House Committee, however, substituted the words "the net liquidation value, as determined by the special court" for the Senate's "constitutional minimum." H.R. 10979. The Report of the House Committee on Interstate and Foreign Commerce, H.R. Rep. No. 725, 94th Cong., 1st Sess. 121 (1975), accurately described the House version but did not explain the reason for the

change from the Senate's. It did contain a letter from the Secretary of Transportation commending "the improvements the Committee made to the provisions on certificates of value" and indicating that if these were to be changed on the floor, "the bill would not be acceptable to the Administration". *Id.* at 282. Faced with this, the Conference Committee adopted the House version, with no explanation other than that

> The role of the certificates of value is to assure that these private interests will fare no worse than under the liquidation alternative.

H.R. Rep. No. 781, 94th Cong., 2d Sess. 199 (1976).

We may agree with the New Haven Trustee that it is hard to see how the change demanded by the Secretary of Transportation benefits the Government in the long run. If the certificates of value, determined on the basis of net liquidation value, plus and minus the other elements requiring consideration, are less than the constitutional minimum, a figure which this Court, subject to review by the Supreme Court, was necessarily left free to determine, the balance would be awarded—not indeed by action of this Court but as a result of further expensive and time-consuming proceedings in the Court of Claims. But quite obviously the Secretary thought he might be accomplishing a change in the standard for determining the base value of the certificates of value, and left Congress no feasible alternative save to go along. This history itself seems to preclude our reading the two terms to mean the same thing, even though the differences may not be so great as the Secretary thought. The term "liquidation" normally implies a sale, although not necessarily a sale for scrap value; the constitutional minimum may well be more—a point we reserve for decision after further briefing.[7] If this analysis is in error, the parties should clearly point out why.

Appendix B

VI. PROCEDURE FOR VALUATION OF PROPERTY OF SECONDARY DEBTORS AND NON-BANKRUPT TRANSFERORS.

There appears to be general agreement that, whatever this Court's ultimate responsibilities may be, the proceedings before the special masters should not concern themselves with the respective interests of lessor and lessee in an award for the same property. We endorse that conclusion and think it is premature to consider how that issue should ultimately be handled.

With a few exceptions the parties seem also to agree that since it will be desirable (although not necessarily sufficient) to value the system of each primary debtor as a whole and since it may be that many elements of VOB (value of other benefits) and CUE (compensable unconstitutional erosion) can be determined only on a system-wide basis, we should appoint special masters with reference to the estates of the primary debtors (doubtless several in the case of the Penn Central) rather than designate separate special masters for each transferor (or group of transferors). We agree with that position. The contrary argument of a few rather small transferors, based largely on the supposed speed with which their problems could be solved, ignores the interdependence of all transferors created by § 303(c)(2) and the undesirability that initial determination by this Court and review by the Supreme Court should take place in what may be a wholly atypical case.

However, there is a difference of opinion whether each special master should content himself with a finding with respect to the system or conduct the hearing so as to enable him to make additional findings with respect to each transferor.

There would seem to be no doubt that under §§ 303(c)(1)(A) and 306(c)(4) findings as to each transferor will ultimately be required. The question therefore is one of relative convenience—will it be simpler and fairer to have the special masters arrive at figures for each system, which presumably we will review, and then start over again with respect to each transferor

within the system, or to conduct the hearings in the estate of each primary debtor with a view to making the separate findings concerning various transferors that will ultimately be needed. We think the latter.[8] Certainly a transferor must be permitted at some time to present a theory (within the parameters established by this Court) resulting in a higher valuation for its property than would result from allocation of a system value; we would think this could better be done in the same proceeding in which the primary debtor is presenting its theory, particularly since a higher value for the property of one transferor might reduce the value of the properties of others. Generally time will be saved if the parties address themselves to the question of relative shares at a date when the necessary figures are more likely to be available rather than postpone the problem to a distant future when records and knowledgeable witnesses may have disappeared. On the other hand, we shall expect the various transferors to live up to their promises of cooperation with the primary debtors and the masters in an effort to minimize time and expense.

Finally, referring to Part II(4) of the June 16 Memorandum, we note that no party has taken the position that the last sentence of § 209(e)(1)—the "reckless or deliberate disregard" clause—applies to valuation proceedings under §§ 303(c)(1)(A) and (B) or 306(c)(4). Accordingly the Court will consider the taking of any such position to be foreclosed.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

.....

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge

October 18, 1976

Appendix B

FOOTNOTES

1. *See* Regional Rail Reorganization Act of 1973, *as amended*, § 209(a) second sentence; Report of the Committee of Conference of S. 2718, H.R. Rep. No. 781, 94th Cong., 2d Sess. 187-88 (1976).

2. A similar suggestion is made by the Trustee of the Central Railroad Company of New Jersey, and by the Intervening Penn Central Lienholders. *Cf.* opening brief of the Trustee of the Lehigh Valley Railroad Company; brief of the Trustee of the Lehigh and Hudson River Railway Company.

3. The FSP, Vol. I, p. 262, limited the designation to the portion of the yard "needed to sustain ConRail operations." The Bank contends that the portion ordered to be conveyed was in excess of this.

4. As noted in the June 16 Memorandum (p. 8), the Government parties suggest that fairness and equity might entitle transferors of particularly strategic properties to larger allocations of ConRail Series B Preferred and common stock, which would give them a larger share in the envisioned future prosperity of ConRail. This issue is a long way off and we need not consider it now.

5. The Government will doubtless claim that a state would not be interested in making the substantial payments required for taking over main line (as distinguished from commuting) operations without assurance that other states would take similar action to the extent required to constitute a viable system. The transferors thus might be well advised in their own interests to develop an "alternative scenario" (or a number of such scenarios) of the sort discussed in the statement of contentions of the Government parties (see June 16 Memorandum p. 15).

6. This brief disregards the limitation imposed by us on granting intervention to the New Haven Trustee, namely, that this was "for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central." June 16 Memorandum p. 26. Our object in allowing intervention by the New Haven Trustee was to permit him to present contentions arising out of the inclusion of the New Haven in the Penn Central, such as, to take one example, a claim that the New Haven's properties having once been valued should not be revalued except to take account of subsequent dispositions and the fact that certain properties were not transferred to

ConRail. It was not and is not our intention to allow the New Haven Trustee to intervene to present positions with respect to valuation issues where the New Haven's interest as a creditor of Penn Central is adequately represented by the Penn Central Trustees.

7. The strongest case would be where a piece of railroad which the Interstate Commerce Commission would allow to be operated shorn of unprofitable track would earn an income whose capitalized value would exceed net liquidation value.

8. There are some instances in which a line is leased or controlled by more than one primary debtor; in these cases the parties have reached or are in the course of reaching agreement as to the estate in which the valuation is to occur.

Appendix B

Addendum

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT[1]

MEMORANDUM AND ORDER DIRECTING PRELIMINARY PROCEEDINGS FOR THE DETERMINATION OF GENERAL PRINCIPLES UNDER §§ 303 AND 306 OF THE ACT

I. HISTORICAL BACKGROUND AND GENERAL CONSIDERATIONS.

In this Court's opinion of September 30, 1974, 384 F. Supp. 895 at 926 n.53, we said that, as we then envisioned, our initial task after the conveyances provided in § 303 of the Act, "would be, after suitable briefing and argument, to set the principles for valuing the properties conveyed." These principles would then be applied to specific properties by a number of special masters, whose decisions we would review. It would have been premature to attempt to analyze just what issues would benefit from such advance determination, and we likewise did not address ourselves to such questions as whether an initial setting of guidelines would require discovery or the taking of evidence.

The extensive amendments made in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976 have considerably augmented the difficulties of what already was probably the most gigantic task ever confided to a court. The added problems arise in considerably part from the Amendments' creation of a new form of security which is to comprise a part of the

consideration payable to railroads that have transferred property to ConRail, namely, "certificates of value" (CV's), § 306, which are to be redeemed by USRA not later than December 31, 1987, § 306(c)(1); the CV's are guaranteed by the Secretary of Transportation, constitute general obligations of the United States, and carry of pledge of its full faith and credit, § 306(a). A separate series of CV's is to be issued to each transferor, § 306(b). Critical to ascertainment of the redemption price is our determination, § 306(c)(4), of the "base value" (BV) of each series. This is computed by determining the "net liquidation value" (NLV), to which the transferor may be entitled by virtue of transfer of property to ConRail, subtracting the value of other benefits provided under the Act (VOB), adding compensable unconstitutional erosion (CUE), and finally adding interest compounded annually at the rate of 8% per annum; to get the BV of each certificate, the figure just obtained is divided by the number of certificates in the series. The formula, omitting the interest item and the final division, thus is:

$$BV = NLV - VOB + CUE$$

A principal problem is that this new concept was superimposed on the concepts of "public interest," "fair and equitable," and "constitutional minimum" in § 303(c) without any clear indication in the statute itself, as distinguished from the legislative history, what Congress considered was the relationship of the securities issuable to the transferors[2] as prescribed by § 306 and the standards laid down in § 303.[3]

The added complexities created by the 1976 Amendments seemed to us to heighten the necessity for this Court to make as many determinations of law as possible, at least in a preliminary fashion, before putting the special masters to work. Putting aside for the moment the secondary debtors of Penn Central (PC) and the non-bankrupt lessors, we have seven primary debtors, and it is apparent that more than one special master will be required in the case of Penn Central (PC) and perhaps in that of

the Erie-Lackawanna (EL) if undue delay is to be avoided;[4] realistically therefore when we speak of special masters, we are thinking in terms of at least ten.

Because of such considerations the Court, on March 9, 1976, sent a letter to all members of the Acting Liaison Committee which the Court had appointed, outlining the Court's tentative views of what legal issues required decision and raising a number of procedural questions. This led in turn to the Court's order of April 26, 1976, prescribing a procedure whereby all parties were invited to file statements commenting on the issues and the structure of this proceeding, with an opportunity to file answers responding to the statements of others. The order also set forth a procedure whereby persons not named as parties might apply for leave to intervene. The Court has now reviewed these statements and answers, many of which have been exceedingly helpful.

While substantially all the comments recognize the existence of some questions which the Court may now determine after appropriate briefing and argument, most take a rather parsimonious view on this score. Although professing to recognize the necessity of providing the special masters with guidelines, many of the proposals seem to be that the special masters shall take evidence on whatever theory passing the lowest threshold of rationality may be offered to them.[5]

We think this would produce utter chaos. If a transferor or security holder[6] is allowed to offer evidence based on a certain theory of value, the Government parties[7] could not afford simply to argue that the theory was wrong; they would be obliged to cross-examine and offer rebuttal on the detailed application of the theory since for aught that would appear we might adopt it. Similarly the special masters would be obliged to make factual findings with respect to all theories even though we were to relieve them of the task (which we would reserve for ourselves) of choosing among them.

While we respect the zeal displayed by the parties, there are other considerations that must be borne in mind. The PC has

already been in reorganization for six years, the CNJ still longer, and the New Haven since 1961. It has now become apparent that a good many months will elapse before the special masters can profitably be put to work in any event. It is impossible to predict how long their labors will take under the best of circumstances, and if we had not already determined the proper principles we would be at the mercy of the slowest, since otherwise our determination in the earlier cases would govern the later ones without having afforded the parties in such cases a hearing. After the masters' reports will come our own consideration and decision on a mammoth record, and appeal to the Supreme Court, and possibly proceedings in the Court of Claims. Until all these steps, save perhaps the last, have been completed, the reorganization courts will be unable to make meaningful progress with their individual plans and the expensive administration of these estates, some of which are understood to be on the verge of actual insolvency, must continue. Indeed we have considerable doubt whether, under the procedures proposed by some parties, the CV's could be valued by December 31, 1987, their redemption date. The legal and other expenses of the litigation in this Court will be tremendous in any event and would become even more staggering and a legitimate subject for public concern if the litigation were protracted beyond the necessities of the case. Given all this and the fact that no procedure can produce a mathematically perfect result, it behooves all concerned with this proceeding to cooperate in devising procedures that will shorten the interval before final decision to the the full extent compatible with essential fairness. We believe it is possible to devise procedures that will enable us to decide a large number of basic questions before the special masters go to work, although there are other matters on which there is no need for an early decision. In saying this we are conscious of the risk that by making some preliminary rulings we may be courting reversal by the Supreme Court and the need of starting all over again; we simply think the danger of this to be less serious than the consequences of letting

the special masters proceed as some of the parties have proposed, see fn. 5. Indeed, as this Memorandum progresses, the need for our making a considerable number of preliminary rulings will become even more evident.

We add one final prefatory note. The complexity of this case, as revealed by the statements submitted to us, has convinced us that the many preliminary issues that must be considered are best addressed in several separate units. What follows is a delineation of these units, with instructions to the parties and intervenors as to how they should proceed as to each. For the convenience of the parties we annex a schedule of the dates fixed for various steps in these preliminary proceedings.

II. Questions which the Court can now decide without presentation of factual material.

There appears to be almost complete agreement that the Court may now decide, without taking any evidence, what we characterized in our March 9, 1976 letter as the "first set" of § 303 issues; indeed, there appears to be a fair amount of agreement how we should decide them. Accordingly we shall set these and some other matters for briefing and argument in accordance with the schedule outlined below:

Initial briefs - August 23, 1976
Answering briefs - September 21, 1976

Time requests for oral argument shall be filed with the answering briefs. In this and all other cases dealt with in this Memorandum and Order, the parties shall arrange for joint briefing and argument to the maximum extent possible and shall keep the length of briefs to the minimum. After studying the briefs and the time requests, the Court — perhaps after a pre-argument conference — will advise the parties of the time, place and organization of the argument.

In light of the statements, we deem it desirable to sharpen the issues as follows:[8]

(1) *"Public interest."* The first question raised in our March 9 letter concerned the nature of our responsibility under § 303(c)(1)(A) to determine whether the transfers and conveyances "are in the public interest . . . ," especially in view of the description of judicial review in the second sentence of § 209(a) and the statement on p. 187 of the Conference Report of January 23, 1976. Several parties suggest that we need only determine that Congress had a rational basis for enacting the Rail Act and make no suggestion that it did not. If that is right, this issue can be regarded as substantially out of the case. However, two other views emerge from some of the statements.

One of these is that the "public interest" test requires us to pass on the viability of ConRail. At the moment we do not understand why we need to do this, just how we should go about it, or what we could do if we decided in the negative since a major reconveyance does not appear to be feasible. If any parties espouse this view, they should develop it in briefs.

The other such view is that although the "public interest" test may have little or no significance for the main body of the conveyances, it may require us to pass on the inclusion of certain peripheral properties or to decide whether, if the Act be regarded as a condemnation statute, certain properties were taken for something other than a public use.[9] It is hard to consider the question *in vacuo*. Any transferor or security holder allowed to intervene who asserts this position shall include in its brief illustrative statements of the properties in respect of which such a claim is made and the supporting reasons; the answer of the Government parties need meet such claims only with respect to legal issues since evidence would have to be taken if the Court were to decide there is need to pursue the matter further. In other words, what the Court needs is factual material sufficient to enable it to decide

whether, if any such claims are made, they have sufficient legal merit to require further development of the facts.

(2) *Fair and equitable.* The second question propounded in the March 9 letter concerned the construction of the "fair and equitable" language in § 303(c)(1), especially in view of the facts (a) that if the consideration is "fairer and more equitable than is required as a constitutional minimum," § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable.

Almost all, perhaps all, the statements seem to agree that the fair and equitable language serves no significant function in the determination of the value of any particular property, although several parties (including the Government parties) have suggested that this language may have a bearing on the allocation of ConRail's Series B Preferred and common stock. There is no need to rule on the latter suggestion now, since it will not be a matter for immediate consideration by the masters. Accordingly the Court will consider the "fair and equitable" issue to have been removed from the process of valuing the properties of individual estates or other transferors unless this is raised in the briefs to be filed as above indicated; any person taking such a position shall state with precision and not merely in conclusory terms how the "fair and equitable" test differs from the constitutional minimum test with respect to valuation in the context of the Act as it now stands.

The March 9 letter also raised the question whether the Court was bound to ascertain by what amount the consideration was less than fair and equitable and, by the same token, less than the constitutional minimum, even though the Court might have no effective way of remedying the defect. Further consideration had led us to an affirmative answer even before receipt of the statements; several of these suggest this and none opposes. Accordingly there is no need to brief this issue.

Appendix B

We pass now to certain other questions of law which we believe the Court may now be able to decide, without taking evidence. These should be briefed and argued in accordance with the schedule set out on [CA-53].

(3) *Reorganization vs. eminent domain statute.* Although not raised in the March 9 letter, a question lurking in the case is whether the standard of valuation[10] should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both. At the moment the Court does not perceive that it should be. Any parties taking a different view should include arguments on that score in their briefs. Some parties also intimate that there may be different procedural requirements if the Act is regarded as an exercise of eminent domain; any party taking this view should brief it.

(4) *Reckless or deliberate disregard.* We include this item in the list, although it may not fit the caption. In the last paragraph of the March 9 letter, we stated we would "like to be promptly advised whether USRA, the United States, ConRail, or any other party represented on LC (Liaison Committee) takes the position that the last sentence of § 209 (e)(1) has any application in proceedings under § 303(c)(1)(A) and (B) or 306 (c)(4)" since, if they did, the Court would desire to receive briefs and hear argument on the statutory and constitutional questions that would be raised. USRA has advised the Court that it does not take that position. Unless any party advances that position in its opening briefs, see [CA-53], the Court will consider that the taking of such a position with respect to proceedings under the cited sections is foreclosed.

(5) *Method of handling the valuation of property not owned by a primary debtor.* The discussions of valuation in the statements of the primary debtors and their security holders seem to assume, without detailed discussion, that the properties are first

to be valued for each estate and that the total will then be distributed, in some way not clearly defined, as between the constituent transferors. This is an almost necessary consequence of the view, espoused by several primary debtors and their security holders, that the transferred property is to be valued as a going concern, and also conforms to what we understand to be the general practice in condemnation proceedings. The FSP, Vol. I, pp. 126, 145, shows separate values for each of the subsidiary debtors of Penn Central, and Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 gives a more detailed breakdown. The statements filed by the lessors seem to assume that they will receive the full value of their properties, without regard to the interest of the lessees; we have not been informed of the position of the latter. It may be that we have here a whole new set of issues which have thus far received relatively little thought.

The Court confesses it is somewhat baffled by the problem which bears, among other things, on the number and the duties of the masters to be appointed, and would welcome detailed proposals and briefing, even though it may be premature to attempt a definitive decision at this time. All parties desiring to express views on how this problem should be handled shall file briefs not later than August 23, 1976, answering briefs not later than September 21, 1976, and time requests for oral argument along with the answering briefs. The Court will then determine what further proceedings shall be had.

III. "Net Liquidation Value."

It is clear that, under § 306(c)(4), the Court is bound to determine the net liquidation value to which the transferors are entitled by virtue of transfers of rail properties to ConRail under § 303(b)(1) as a step in determining the BV of the CV's, whether the value of the securities (including the CV's) issuable

to the transferors is the same as or more or less than the Constitutional Minimum Value (CMV). The statements, however, reveal serious differences of opinion how this task should be performed.

A.

USRA's approach is summarized in FSP, Vol. I, pp. 124-26, and is stated in considerable detail in an Appendix, Vol. I, pp. 141-55. The essence of USRA's method is captured in the following paragraphs on p. 125:

> To resolve these and other issues, USRA postulated a "master liquidation plan" describing in detail an orderly process for the disposition of each estate's assets. The key assumption of the plan is that the estates would be required to sell substantial assets for continued rail use but that the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses. USRA assumed further that because of the valid requirements of common carrier regulations, the estates would operate under subsidies, if need be, and maintain their rail operations until 1979, at which time the orderly liquidation would begin. This subsidy period is also consistent with the self-interest of the estates in maintaining healthy price levels for their assets. USRA's plan also makes the favorable assumption that orderly cessation actually occurs and, therefore, prices are not adversely affected by the economic dislocations which would result if the actual service termination were abrupt and not orderly. The master liquidation plan also recognizes the physical requirement for preparing assets for sale and their effect on the timing of asset disposition.

> In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates to other railroads with the prices of such transfers computed as if the estates had actually been allowed to exercise their asserted right to liquidate by selling all of their assets for nonrail uses. The pricing under the assumption of total liquidation is based on supply and demand conditions which such a time-phased liquidation of rail assets into nonrail uses would produce. The pace of such asset disposition is tied to the time required to accomplish a transition to alternate modes and to prepare assets for sale.

We have no doubt that this is one theory of determining net liquidation value that must be considered. However, as indicated in the March 9 letter, even if USRA's general theory were to be accepted, its calculations depend on a considerable number of assumptions which are open to contest.

We cite as examples, but without limitation, "[a]ssessments of the time and cost of preparing the assets for sale, and the expected time required to dispose of such assets once prepared for sale in light of supply and demand conditions" (p. 125); "[t]he overall economic environment within which these activities would occur" (p. 125); the method for arriving at the discount factors stated at p. 126; the details of the calculations as to when all necessary authority to sell rail properties would be obtained, pp. 145-46 (including the question whether, if certain transferors would have been obliged to shut down for lack of funds, any such authority would have had to be obtained); what was done in regard to properties that may be "rail properties" within the Act but are not in the sense that authority to sell would have to be obtained; and the assumptions with respect to the determination of the value of rolling stock (pp. 146-48), facilities (pp. 148-49) and real estate (pp. 149-51).

Appendix B

In order to avoid wildly conflicting approaches by the masters appointed to deal with particular transferors, it seems essential that the Court, perhaps with the assistance of one or more Special Masters, should pass on the general validity of these assumptions, even though we recognize that any decision on this would simply establish something like a presumption which could be challenged by any transferor, e.g., by showing that it could have obtained authority to abandon at a date earlier than that hypothesized by USRA (or would not have required such authority because of lack of funds or for other reasons) or that it was in a peculiarly favorable position to sell rail ties. The transferors insist that before anything can be done in the way of briefing, there must be extensive discovery of the details of USRA assumptions and the basis for them.

While we agree that some discovery is needed before there can be any effective briefing, we believe this should be in two stages. The first stage would be devoted to general questions such as those we have outlined. The second stage, which could go on while we were considering these general issues, would relate to more specific matters, e.g., the correctness of the count of rolling stock, track, etc., or the validity of the choices of other real estate sales selected to determine market value.

USRA has now taken an important first step by serving on the parties copies of its Master Liquidation Plan and of five valuation reports. While we do not anticipate that these will satisfy transferors even with respect to first stage discovery, this submission should suffice to enable them to formulate requests, which can then form the subject of consideration by the Acting Liaison Committee, substantially as proposed in the June 7, 1976 response of the Government parties, pp. 13-15. We direct the parties and the Acting Liaison Committee to proceed along these lines with respect to what we have characterized as first stage discovery of NLV methodology used by USRA and by any of the transferors and the Acting Liaison Committee to report to us no later than August 23, 1976.

B

We now turn to another and more basic matter. The chief quarrel on the part of the transferors and security holders with USRA's general approach to the determination of NLV, summarized in the paragraph quoted from FSP. Vol. I, p. 125, as distinguished from the subsidiary assumptions leading to the final figures, and also as distinguished from the question whether CMV is higher than the value of the securities issuable to the transferors, relates to the second sentence. Many of the statements claim that, at least for certain properties, the maximum liquidation price would be attained by selling them for railroad use.[11]

We do not understand that the statements of the Government parties altogether dispute this, see pp. 12-17 of the opening statement and pp. 9-12 of the responsive statement. After outlining a formidable series of hurdles that, in their view, a transferor would have to overcome before he could establish that sale to another railroad would yield more than sales for non-rail use, and urging that on this account, "the Court should presume that no hypothetical combination of dispositions would have produced a value higher than that attainable in a disposition of all of the transferred properties for nonrail use," they concede that "[t]his presumption could be overcome by a showing by a transferor that . . . it could and would legally and feasibly have disposed of some or all of its properties, for rail use, at a value determined other than by reference to the value attainable in a liquidation for nonrail use," (p. 17).

The Government parties argue that before any transferor can be allowed even to attempt this showing, there must be a preliminary proceeding in which, as we understand it, all transferors seeking to make the attempt must develop a consistent "alternative scenario" and the Court is to pass upon its feasibility, considered as a whole. While the presentation of such a plan would greatly facilitate our consideration, the Government parties have

not indicated how we could compel this. At the moment we are not persuaded that the procedure proposed by the Government parties is necessary or even feasible. The subject can be more intelligently considered when we know what transferors intend to show more advantageous dispositions for rail use and with respect to what properties.

Before we request transferors to advance their proposals, there seems to be a point of law the decision of which will importantly affect the proceedings. Several transferors appear to include in their claim that NLV should take account of higher prices obtainable for rail than non-rail use not only sales of certain properties to solvent railroads (or other private groups if any such were possible purchasers) but also sales of other properties to public bodies vested with the power of condemnation. At the moment we do not understand why in the absence of competing private purchasers, such public bodies could be expected to pay more than the NLV for nonrail use.[12] We think this question can be usefully briefed, argued and decided along with those enumerated in Part II, Items (1), (2) and (3). The question is this:

> Assuming that in determining "net liquidation value" as used in § 306(c)(4) the Court should take account of a higher price obtainable for certain properties on a sale for rail use rather than, as USRA proposed, "at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses" (FSP, Vol. I, p. 125), should the Court do this when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?

Once the Court answers this question, the next step would be to require the transferors to enumerate the possible transfers they

desire to have considered. It may be that, as suggested by the PC Trustees (p. 23), the transferors will require the aid of discovery to assist them in doing this; the Government parties say that on this and other subjects discovery should be reciprocal. USRA could expedite matters if it would promptly make available to transferors any information which it has in regard to the interest (or lack of it) displayed by private parties in acquiring parts of the properties conveyed to ConRail, including the history of the aborted negotiations with the Chessie and the Southern; the transferors should similarly make available to the Government parties facts as to efforts made by them to effect such sales. The mechanics for this should be discussed in the Acting Liaison Committee and included in the report directed above. When the transferors have formulated their proposals, it may well be desirable to utilize the two-phase process suggested by the PC Trustees — a first phase in which the Court, perhaps aided by a Special Master, would determine the feasibility of the proposed transfers, and a second phase ascertaining the prices that would have been obtainable.

A number of the transferors have advanced theories for determining NLV that seem to have nothing to do with "liquidation," particularly in the light of the discussion at p. 199 of the Conference Report. As at present advised, we believe that the place for these theories is in the consideration of the constitutional minimum, which we will discuss in Part V of this Memorandum. The briefing and argument of the validity of these theories which is there directed can include the point raised in the two preceding sentences.

IV. Other problems in arriving at the Base Value of the Certificates of Value.

Since the discussion in Part III has taken us a considerable distance into the problems of § 306(c)(4), it will be convenient to

complete our discussion of that section before returning to § 303(c)(1).

We think it would be desirable to separate the determination of BV into its three component parts, NLV, VOB, and CUE. We take it that Appendix A to the Master Liquidation Plan and Summary of Valuation Reports dated March 1, 1976 broadly reflects the position of the Government parties as to NLV. Any further revisions to take account of additional designations, property sales, and the changed conveyance date should be made promptly.

USRA has outlined its theories as to the determination of VOB in FSP, Vol. I, pp. 128-34. However, the FSP says that it had been "impossible within the statutory deadlines to arrive at any final quantification as to all categories of 'other benefits'"; that the figures given are at least in part "estimates and approximations"; and that USRA's "analysis will continue as regards both the quantification of established categories and the possible identification and quantification of additional categories." Most of the transferors claim that there are no, or few, "other benefits"; they also say that the failure of FSP to trace how the general principles stated on pp. 128-33 were translated into the figures in Tables 2 and 3 makes it impossible for them to voice their objections intelligently.

We think there is merit in the latter point, at least to the extent that the argument would be more meaningful if more details were known. We therefore direct USRA to prepare and file a more detailed explanation and calculation of VOB, taking such account as it thinks warranted of the criticisms in the statements. The objective would be to provide a statement in sufficient detail that we could rule on the issues of principle (i.e., whether a particular category did or did not constitute a benefit) on the basis of USRA's statement and opposing affidavits going into principle rather than detail and thereby eliminate, as to categories we might rule out, the need for further discovery or factual presentation. USRA is directed to file such a statement not later than

December 1, 1976. Again we urge USRA to be as forthcoming as feasible in its statement; the more that is voluntarily disclosed, within the realm of reason, the better are the chances for our being able to issue instructions to the masters without unnecessary advances discovery and taking of evidence. We also take note of the contention of some transferors that the benefits, in whole or in certain categories, are negative, and the legal problem arising therefrom. We believe that, at the appropriate time, this also can be handled by briefs supplemented with illustrative factual material — not in the sense of determining precise figures but in that of deciding whether the contention that "negative benefits" should be added rather than subtracted, or the more modest proposal that a "negative benefit" in one category is to be offset against positive benefits in others, are legally sustainable.

Turning to CUE, it now appears to us that there are three sets of legal issues which can be determined without awaiting the completion of detailed studies on the subject; indeed a relatively early resolution of these issues is essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE.

Two of these issues concern the period of erosion claims. The statement of the Government parties takes the position, p. 28 n.19, that there can be no valid erosion claim for any period prior to enactment of the Rail Act — a position finding at least some support in our earlier opinion, 384 F. Supp. at 925. The transferors disagree. Secondly, some transferors take the position that there can be valid erosion claims for periods after the March 31, 1976 conveyance with respect to property not conveyed. The Government parties presumably disagree. The third concerns the nature of the items qualifying as erosion claims. The statement of the PC Trustees (pp. 11-12) helpfully subdivides erosion into "financial erosion" and "physical erosion." The former would include the four items mentioned in our earlier opinion, 384 F. Supp. at 923, and possibly others of similar nature. Physical erosion is the deterioration of plant which may result in a

lower NLV for the properties conveyed and lower realizable values for those not conveyed. We think the two issues of dates and the issue of the nature of the items qualifying for treatment as CUE can be resolved, or at least narrowed, as a matter of principle on the basis of factual submissions without the taking of detailed evidence since we would not anticipate serious conflict on the facts. We direct that all persons making claims of CUE shall file not late than October 18, 1976 detailed statements with supporting briefs which shall include the following:

(1) The date when they contend that valid erosion claims began. These should be supported by inclusion of petitions, reports and orders in the various reorganization courts and financial data that are claimed to be relevant.

(2) Any date later than March 31, 1976 to which they contend that erosion continued. The statements should give some idea of the nature and amount of any such post-conveyance erosion claims and shall present the legal theory contended to support them.

(3) The categories (and some approximation of the amounts) of erosion claims.

The Government parties shall answer not later than November 15, 1976, and the claimants may reply not later than December 7, 1976. The Court will then set a date for argument.[13]

V. Constitutional Minimum Value.

While, as mentioned in Part III of this Memorandum, Congress was of the opinion, Conference Report p. 199, that by providing for CV's it had assured the transferors of the constitutional minimum, that opinion is, of course, not conclusive. As also mentioned in Part III, we are presently of the view, while this is subject to change after brief and argument, that when Congress

spoke of liquidation, it meant liquidation, although liquidation is not necessarily sale exclusively for nonrail use. Unless further briefing and argument should alter the view stated in the preceding sentence, we would consider, as previously indicated, that many of the contentions with respect to an expansive notion of NLV should rather be regarded as contentions that even an application of NLV taking full account of possible dispositions for rail use may not produce values equal to the constitutional minimum.

It would seem that if a railroad (or a segment which would have been allowed to operate pruned of unprofitable extensions) has capitalized earning power in excess of NLV, even in the "world" where most of the rail service provided by the bankrupt estates has ceased, the Constitution would require payment on that basis. If the Government parties contest this proposition, or desire to frame conditions about it which they believe we should impose as guidelines to the masters, they should include a discussion of this in their opening briefs.[14]

Apart from this the statements and answers can be said generally to reveal the clash manifested by the majority and dissenting opinions in *In the Matter of the Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734 (1967). Putting the matter in another way, they raise the issue whether and, if so, how far the Supreme Court would consider that the situations here presented require a departure from the standard that in condemnation "the question is what has the owner lost, not what has the taker gained," *Boston Chamber of Commerce* v. *City of Boston*, 217 U.S. 189, 195 (1910), and subsequent decisions. We see no reason why we cannot formulate at least a general position on this subject without requiring the special masters to take detailed evidence on some or all of the many theories of valuation that would run afoul of the quoted standard if this is applicable. In saying this we do not mean to limit the parties to ordinary legal briefs. If any party believes it would be helpful to accompany its brief by affidavits or offers of proof, it may do so; the Court will consider these not as proof of the facts stated but for the light they

shed on the legal issues. Such a course will meet the Supreme Court's comments in *Regional Rail Reorganization Act Cases*, 419 U.S. 102,146 (1974), without requiring the vast expenditure of time and money that would follow from our leaving the issue of the constitutional minimum wholly at large until the masters have reported.

That issue, as we now see it, is whether the Constitution requires any valuation in excess of NLV properly defined, and as then used in § 306, plus any higher valuation of a railroad or segment derivable under the second paragraph of this Part V. Illustrative of the theories of valuation that would seem to fall if that question were to be answered in the negative are those propounded as theories of NLV in the statements of the Trustees of the Lehigh Valley, pp. 11, et seq.,[15] of the Erie Lackawanna, pp. 11, et seq.,[16] and of the Penn Central Trustees, pp. 9-11; those propounded as theories of the constitutional minimum in the statements of the Penn Central Lienholders, pp. 9, et seq.,[17] and the Committee of Secured Rail Creditors in the Penn Central Transportation Company Reorganization Proceedings;[18] the "true economic value" theory of the Penn Central Company; and the theory of the New Haven Trustee.[19] We emphasize that by mentioning the contentions of these parties as illustrations we are not relieving others who contend for a value higher than that formulated in the first sentence of this paragraph.[20]

There are three subsidiary issues that appear to require special briefing:

The first is this: Assuming that our answer to the question put above were to be generally in the negative, are there specific properties as to which valuation on the basis of NLV or a higher value based on capitalized earnings would be so manifestly unfair, because both factors work out at or near zero, that a higher value must be found and, if so, on what basis? This is essentially the question put by Judge Keating with respect to the Hudson River tunnel properties in *In the Matter of the Port Authority Trans-Hudson Corp., supra*, 20 N.Y.2d at 470, 231 N.E.2d at 739-40.

While long tunnels of this sort are the paradigm, the transferors are invited to suggest other categories.

A second question, raised by the statement of the New Haven Trustee, is whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any higher basis than other properties.

A third issue, raised explicitly by the Lehigh Valley Trustee (pp. 23-24) but potentially of broad application, is whether the Constitution requires that compensation be given for any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise. Here again, we would expect those propounding this point to give sufficient examples to enable the Court to understand the nature of the claimed diminution, not necessarily in dollar amounts but by categories.

We recognize the possibility that, after the briefing and argument here directed, we may decide that some of the issues propounded in this Part V are not ripe for decision, or may determine to afford the Special Masters greater leeway (possibly in the form of permitting requests for further instructions) than we now contemplate. Nothing will have been lost, however, since the issues set forth in this Part V will have to be briefed and argued at some time in any event, and the benefit attainable from our ruling in 1977 rather than many years later, after prodigious efforts before and by the special masters, which may be unnecessary, is so tremendous.

Recognizing that the issues raised in this Part V are of great consequence and that factual materials may need to be assembled, we shall allow considerably more time for the filing of papers. We set the following schedules:

Presentation of proponents - January 6, 1977

Presentation of Government parties - February 20, 1977

Replies of proponents - March 18, 1977

We shall defer fixing a date for argument until the papers have been filed.

VI. Petitions for leave to intervene.

In view of the large number of parties entitled to participate in these proceedings as a right, the Court cannot be as liberal in granting interventions as it might like to be. Indeed in some ways the intervention of creditor and stockholder interests may be counterproductive; insofar as they merely repeat arguments already ably made by transferors, they diminish the force of the latter. Paraphrasing Mr. Justice Stewart's well-known remark in *New York Times Co.* v. *United States*, 403 U.S. 713, 729 (1971), when everyone is heard, no one is heard. We are also mindful of the considerations concerning expense mentioned in Part I of this Memorandum. We are therefore granting intervention in these proceedings for the establishment of general principles to intervenors who have demonstrated a legal interest in the outcome and have taken or propose to take positions different from that taken by the transferors. When interventions shall be granted in proceedings relating to the application of the general principles to specific properties can be determined later.

Applying this criterion, we grant intervention in the proceedings provided for in this Memorandum and Order to the following:

Institutional Investors Penn Central Group and certain Penn Central Indenture Trustees.

The First National Bank of Chicago as Trustee under First Mortgage Indenture of the Chicago River and Indiana Railroad Company, for the limited purpose of presenting arguments pertaining specifically to the C.R. & I.

Provident National Bank and A. Wakelee Swartz, Jr., as Indenture Trustees for Pennsylvania Tunnel and Terminal Railroad Company, and the Bank of New Jersey, as

Indenture Trustee for New York Connecting Railroad Co., for the limited purpose of presenting arguments pertaining specifically to the named railroads.

Citibank, N.A., as Agent for the Committee of Secured Bank Creditors in the Penn Central Transportation Company Reorganization Proceedings, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the theory of valuation discussed in its petition and accompanying statement.

Richard Joyce Smith, Trustee of the Property of the New York, New Haven & Hartford R.R. Co., for the limited purpose of presenting contentions pertaining specifically to properties transferred by the New Haven estate to Penn Central.

Penn Central Company, for the limited purpose of presenting in proceedings under Part V of this Memorandum and Order the issues outlined in its petition and accompanying statement.

The following applications are denied for lack of a sufficiently specific showing of inadequacy of representation by other parties in the proceedings provided for in this Memorandum and Order and, in some instances, for failure to file a statement of contentions as required by this Court's order of April 26, 1976:

Joint Application of Morgan Guaranty Trust Company of New York and eight other indenture trustees of Erie Lackawanna Railway Company

Joint Application of Girard Trust Bank and four other indenture trustees of Lehigh Valley Railway Company.

Petition of John W. Sullivan, John D. Mabie, and Thomas A. Reynolds, Jr., minority stockholders of Reading Company.

Appendix B

Petition of Minority Stockholders of Mahoning Coal Railroad Co.

Petitions for leave to intervene have been filed on behalf of five governmental bodies listed in the margin.[21] As to almost all of the questions set forth in this memorandum, we fail to see that these bodies have an interest justifying even permissive intervention; the only exception would be if a contention were to be made that some of the transfers were not in the public interest, see Part II (1). These petitions are denied without prejudice to applications for limited intervention in the event indicated.

This constitutes an order; the parties shall proceed in accordance herewith.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge /

June 16, 1976

Appendix B

FOOTNOTES

1. The Court has adopted a new caption and docket number for general matters relating to the valuation proceedings under §§ 303(c) and 306. All papers subsequently filed in general proceedings dealing with valuation shall bear this caption and docket number. The Court will enter an order transferring from Docket Misc. No. 75-3 matters relating to these general valuation proceedings and also breaking Misc. No. 75-3 into various categories.

2. We use the term "securities" to include other forms of consideration moving to a transferor.

3. The problems would have been less under the bill as passed by the Senate which used the phrase "constitutional minimum" instead of NLV.

4. The valuation of the New Haven took four years even though there was general agreement that the property should be valued primarily on a scrap value basis.

5. Thus the statement on behalf of Reading Company and its wholly-owned subsidiaries says (p. 13):

> Therefore, the only proper instructions that this Court can give the Special Masters is to hear all evidence pertaining to value each party desires to introduce and to structure the appropriate theory of valuation at the end of the proceeding.

6. We use this term to include indenture trustees.

7. For present purposes, we include ConRail along with the United States and USRA in the term "Government parties."

8. It should be clearly understood that any expressions in this Memorandum and Order which relate to the merits or to procedures not herein prescribed are designed solely to assist in structuring these proceedings and do not indicate a prejudgment.

9. Here, as elsewhere in this Memorandum, we will take it for granted that parties who wish to establish that a question that has been raised has constitutional as well as statutory dimensions will develop the point in their briefs.

10. We use this phrase so as to exclude for present purposes the question whether to the extent that the statute is an eminent domain statute, as the non-bankrupt transferors claim is necessarily is as to

them, and as some other parties claim as well, the Constitution requires that the consideration be paid in cash.

11. This contention is to be distinguished from the argument that for certain segments the "highest and best use" would be retention by the transferor for railroad purposes. This sounds rather on the claim that CMV may exceed the value of the securities issuable to the transferors, although a determination of capitalized earnings would have evidentiary value for both.

12. Except, of course, in a situation similar to that envisioned in fn. 11.

13. The Trustee of the Ann Arbor has raised an issue of law peculiar to it. Since this estate has conveyed no property to ConRail, it will not obtain CV's. The Trustee wishes us to decide whether we have power to enter a deficiency judgment for CUE under § 303(c)(3) and direct payment by the United States under § 303(c)(5). If we should decide in the negative, the Trustee would like to proceed directly in the Court of Claims. We think it preferable to defer decision on this at least until we have passed on the general questions with respect to erosion outlined above.

14. In our 1974 opinion, 384 F.Supp. at 928 n.61, we took note of a theory which we thought to be then suggested by the Government parties, namely, that the constitutional minimum might be less than liquidation value in the case of a railroad (or perhaps a segment) with earnings which were sufficient that it could not obtain permission to abandon but whose capitalized value was less than liquidation value. The Government parties do not now seem to urge this except for making the point that if ConRail has sufficiently large earnings, there may be no need for determining net liquidation value. If the Government parties wish to preserve the contention adverted to in the cited footnote, they should also include an argument on this in their opening briefs.

15. Real estate at fair market value plus an assemblage factor:

Improvements at the higher of a scrap value or going concern value:

Going concern value measured by a combination of:

Capitalized prospective earnings

Public usefulness (the price of reconstruction or of a substitute facility)

RCNLD in appropriate instances

Value in place (i.e., scrap value with no subtraction for dismantling).

16. Capitalized earning power as basis for sale to another railroad;

Gross liquidation value (i.e., no cost for dismantling) as basis for sale to another railroad;

"Special Value" to a public body (e.g., a state) calculated by some combination of:

Depreciated value of track

Market value of land, plus assemblage factor

Gross liquidation value

Value of a developed operating organization

Value of not having to develop more costly alternatives

RCNLD of special facilities;

"Residual Value"—i.e., value as an integrated network.

17. Value properties as an assembled unit (i.e., apparently as a "going concern") by an appropriate combination of:

Land at fair market value plus assemblage;

Track at depreciated value;

Related facilities at cost plus appreciation;

Intangibles at cost of production less obsolescence;

For special facilities, RCNLD;

Value to public in terms of costs of alternatives.

18. "[W]hat it would have cost an acquiring entity on April 1, 1976 to buy, in an arm's length transaction, the conveyed real estate and to then build an integrated rail system . . . on that real estate . . . . (p. 4)"

19. Presumption of reconstruction cost new less depreciation unless the Government parties rebut this.

20. We have not mentioned the contentions of the Government parties as to "ConRail use value" since we do not understand their precise relevance. If the Government parties wish these to be considered as part of the proceedings here contemplated, they should make a further submission on the subject not later than August 15, 1976.

21. The Commonwealth of Pennsylvania, the State of Delaware, the Department of Transportation of the State of New York, the Maryland Department of Transportation and the City of Philadelphia.

Appendix B

Schedule

Subject

(1) "Public interest"; "fair and equitable"; reorganization vs. eminent domain statutes, reckless or deliberate disregard clause, § 209(a)(1)—see Part II, Items (1), (2), (3) and (4); relevance of possibility of sale for rail use to public bodies having power of condemnation, see Part III.

Opening briefs—August 23
Answering briefs—September 21

(2) Method of handling the valuation of properties not owned by primary debtors, see Part II, Item (5).

Opening briefs—August 23
Answering briefs—September 21

(3) Report by Acting Liaison Committee with respect to first stage discovery on NLV methodology and on efforts by USRA and transferors to effect sales for rail use to private parties.

August 23

(4) Date on which USRA shall file detailed statement of value of other benefits.

December 1

(5) Filing by transferors of statements and briefs with respect to uncompensated unconstitutional erosion: October 18

Response by Government parties: November 15
Replies: December 7

(6) Briefs (accompanied by affidavits or offers of proof) on constitutional minimum.

Opening briefs—January 6
Answering briefs—February 20
Reply briefs—March 18

APPENDIX C

Appendix C

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed April 19, 1977, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS
UNDER §§ 303(C) AND 306 OF THE
REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

David B. Isbell, Esq., Washington, D.C. (Edwin M. Zimmerman, Esq., Jeffrey S. Berlin, Esq., Jeffrey G. Huvelle, Esq., and Covington & Burling, Esqs., Washington, D.C.; John B. Rossi, Esq., Philadelphia, Pa., of Counsel), for Penn Central Trustees and Certain Affiliated Transferors.

David C. Toomey, Esq., Philadelphia, Pa. (Jared I. Roberts, Esq., and Duane, Morris & Heckscher, Esqs., Philadelphia, Pa., of Counsel), for Trustee of the Lehigh Valley Railroad Company.

Harry G. Silleck, Jr., Esq., New York, N.Y. (John L. Altieri, Jr., Esq., and Mudge Rose Guthrie & Alexander, Esqs., New York, N.Y., of Counsel), for Trustees of Erie Lackawanna Railway Company, and Certain Affiliated Non-Bankrupts.

Stanley Weiss, Esq., Newark, N.J. (M. Elaine Jacoby, Esq., Dean R. May, Esq., and Carpenter, Bennett & Morrissey, Esqs., Newark, N.J., of

Counsel), for Trustee of the Central Railroad Company of New Jersey.

Louis A. Craco, Esq., New York, N.Y. (Walter H. Brown, Jr., Esq., Thomas L. Bryan, Esq., Michael B. Targoff, Esq., Rebecca T. Halbrook, Esq., Richard L. Posen, Esq., and Willkie Farr & Gallagher, New York, N.Y.; Frederic L. Ballard, Sr., Esq., and Ballard, Spahr, Andrews & Ingersoll, Esqs., Philadelphia, Pa., of Counsel), for Intervening Penn Central Lienholders.

Joseph Auerbach, Esq., Boston, Mass. (Morris Raker, Esq., Thomas Wardell, Esq., Thomas D. Halket, Esq., Harvey E. Bines, Esq., and Sullivan & Worcester, Esqs., Boston, Mass.; James Wm. Moore, Esq., New Haven, Conn. of Counsel), for Trustee of The New York, New Haven and Hartford Railroad Company.

Howard H. Lewis, Esq., James A. Sox, Esq., and Obermayer, Rebmann, Maxwell & Hippel, Esqs., Philadelphia, Pa.; Lockwood W. Fogg, Jr., Esq., Plymouth Meeting, Pa., for Trustees of the Reading Company and for its Wholly-Owned Subsidiaries.

Timothy V. Smith, Esq., New York, N.Y., for Trustee of The Lehigh and Hudson River Railway Company.

Joseph J. Connolly, Esq., and Goodman & Ewing, Esqs., Philadelphia, Pa.; Herbert G. Schick, Esq., and Hepburn, Ross, Willcox & Putnam, Esqs., Philadelphia, Pa.; Jerome K. Walsh, Esq., and Walsh & Frisch, Esqs., New York, N.Y., for Secondary Debtors of The Penn Central Transportation Company.

Charles I. Thompson, Jr., Esq., Philadelphia, Pa., for The North Pennsylvania Railroad Company, the Delaware and Bound Brook Railroad Company, and Philadelphia, Germantown and Norristown Railroad Company.

Perrin C. Hamilton, Esq., and Hamilton, Darmopray & Malloy, Esqs., Philadelphia, Pa., for the East Pennsylvania Railroad Company.

Alan C. Kauffman, Esq., and Obermayer, Rebmann, Maxwell & Hippel, Esqs., Philadelphia, Pa., for the Peoria and Eastern Railway Company.

Joseph S. Radom, Esq., and Thomas B. Radom, Esq., for Trustee of the Ann Arbor Railroad Company.

George F. Galland, Esq., Robert W. Ginnane, Esq., and Galland, Kharasch, Calkins & Brown, Esqs., Washington, D.C., for Norwich & Worcester Railroad Company.

William T. Lake, Esq., and Louis R. Cohen, Esq., Washington, D.C. (Lloyd N. Cutler, Esq., William R. Perlik, Esq., David R. Johnson, Esq., and Wilmer Cutler & Pickering, Esqs., Washington, D.C.; Kevin P. Charles, Esq., Robert H. Kapp, Esq., Howard R. Moskof, Esq., George W. Mayo, Jr., Esq., and Hogan & Hartson, Esqs., Washington, D.C.; Cary W. Dickieson, General Counsel, Stephen C. Rogers, Deputy General Counsel, and Jordon Jay Hillman, Special Counsel, United States Railway Association, Washington, D.C., of Counsel), for United States Railway Association.

Appendix C

Paul M. Tschirhart, Esq., Department of Justice, Washington, D.C. (Rex E. Lee, Assistant Attorney General, and John H. Broadley, Esq., Dept. of Justice, Washington, D.C.; Donald T. Bliss, Deputy General Counsel, Alexander P. Humphrey, Esq., and Justine Fischer, Esq., U.S. Dept. of Transportation, Washington, D.C. of Counsel), for United States of America.

Appendix C

FRIENDLY, Presiding Judge:

I. INTRODUCTION

Section 303(c)(1)(A) and (2) of the Regional Rail Reorganization Act of 1973 as amended (the Rail Act) directs this court to determine whether the transfers and conveyances which took place on April 1, 1976, were for a consideration more or less than the constitutional minimum[1] "taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad".[2] Section 306(c)(4) provides that one item to be included in the base value of each series of certificates of value (CV's) authorized by § 306 shall be "such amount, if any, as the special court may determine shall be required after taking into consideration compensable unconstitutional erosion, if any, in the estate of a railroad in reorganization, or of a railroad leased, operated, or controlled by such a railroad, which the special court finds to have occurred during any bankruptcy proceeding with respect to such railroad".[3] These provisions appeared for the first time in the amendments made by the Railroad Revitalization and Regulatory Reform Act of 1976 (RRRRA), evidently in response to indications in our opinion of September 30, 1974 (180-Day Appeals), 384 F. Supp. 895, 918-26, and the Supreme Court's opinion in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 122-25 (1974), that the process provided by the Rail Act might involve what the Supreme Court called an "erosion taking" of property of the transferors for which the Fifth Amendment would require just compensation. Because of the limited powers accorded us by the original Rail Act with respect to securities issuable to the transferors, those opinions envisioned that the task of determining the existence and amount of such erosion would devolve primarily upon the Court of Claims under the Tucker Act, 28 U.S.C. § 1491; the effect of the 1976 amendments was to

transfer that task, or at least the bulk of it, to this court.[4] The claims are large; and approximation of the claim of the Penn Central Trustees for pre-conveyance erosion runs to nearly $900 million.

In our Memorandum and Order of June 16, 1976, Directing Preliminary Proceedings for the Determination of General Principles under §§ 303 and 306 of the Act (June 16 Memorandum), we identified "three sets of legal issues" with respect to compensable unconstitutional erosion (CUE) which we thought could be presently "determined without awaiting the completion of detailed studies on the subject".[5] 425 F. Supp 276, 284-85. These were:

> (1) The date when the transferors contend that valid erosion claims began;
>
> (2) Any date later than March 31, 1976 to which the transferors contend that erosion continued:
>
> (3) the categories (and some approximation of the amounts) of erosion claims[6].

Consideration of the briefs and arguments has led us to conclude that it would be best to defer decision on the item of post-conveyance erosion claims, identified above as (2). These claims fall into three categories— interest on loans made pursuant to § 211(h); alleged inadequacy of rentals for property subject to rail service continuation payments under § 304(c)(2);[7] and erosion with respect to properties designated as "suitable for use for other public purposes" and required to be temporarily retained under § 304(b)(2). The nature of these claims is altogether different from pre-conveyance CUE claims; their amount, if any, is not now determinable; decision with respect to some (notably the second) may be dependent on later decisions in the valuation phase of the case; and failure to pass upon them at this time will

not delay the progress of these proceedings.[8] Both the Government parties and those transferors who spoke on the matter indicated a willingness to have us postpone consideration of these issues. We shall thus defer decision on them, with the proviso that at any time this court may, or any party may request us to, restore all or some of these questions to the active list, with proper notice and such further opportunity, if any, for additional briefing and argument as we may think appropriate.

We shall therefore deal in this opinion only with pre-conveyance CUE claims. As was suggested at the argument, we shall treat the brief of the Government parties as a motion for summary judgment that, subject to certain reservations hereafter noted, there are no valid claims. Further we shall deal in this opinion only with the issue of when, if ever, such claims began to accrue.

The organization of the balance of this opinion shall be as follows: In Section II, after a brief statement of the general nature of the claims, we shall set forth the history giving rise to the claim of the Penn Central Trustees. This will be followed by Section III in which we shall analyze the authorities. In Section IV we shall state our general conclusions in regard to the accrual of pre-conveyance CUE and apply these to the Penn Central. A further Section V shall deal with the claims of other bankrupt estates for pre-conveyance CUE, and in a final Section VI we shall make some concluding remarks.

II. The Nature of the Claims and the History Giving Rise to the Claim of the Penn Central Trustees

The term "compensable unconstitutional erosion" is a newcomer to the legal lexicon.

As recognized in our previous opinions, June 16 Memorandum, 425 F. Supp. at 284-85; see *In re Penn Central Transportation Company*, 384 F. Supp. 895, 923 (1974), "erosion" of estates such as those of the railroads here before us falls into two major

categories. Financial erosion arises from the creation of claims such as administration expenses, trustees' certificates, and taxes which have priority over the claims of pre-bankruptcy creditors, and use for operations of cash or property held as security for liens. Physical erosion consists of the depletion of property through such means as loss of nonescrowed cash and deterioration of physical plant, which result in the property having a lesser value at the end of the period than at the beginning.[9]

Erosion as such has no constitutional implications; it is suffered in some forms by many losing businesses outside bankruptcy as well as within it and by commercial or manufacturing enterprises as well as by public utilities. Unconstitutional erosion arises only when a losing business has been required to continue to operate against its will for more than a reasonable period.

It is not clear just what Congress considered it was adding by the adjective "compensable". Perhaps it was of the view that even unconstitutional erosion was not always compensable, but if so, it did not state what the critical factors were deemed to be. In the preceding paragraph we deliberately used the passive voice "has been required" and did not elaborate on the meaning of the verb "require". By adding the word "compensable" Congress may have meant to emphasize the importance of two elements that are implicit in the concept of "unconstitutional" erosion itself, namely, that the claimant should have made manifest its desire to quit operating and should have applied for authorization necessary to that end, and that some identifiable agency of government having power to do so should have thwarted its desires.

The principle underlying the claims for CUE derives from three Supreme Court decisions of the early 1920's, *Brooks-Scanlon Company* v. *Railroad Commission of Louisiana,* 251 U.S. 396 (1920); *Bullock* v. *Florida ex rel. Railroad Commission of Florida,* 254 U.S. 513 (1921); and *Railroad Commission of Texas* v. *Eastern Texas Railroad,* 264 U.S. 79 (1924). All three involved small railroads[10] whose business had become so unprofitable that they could not continue operations except at a loss.[11]

The Supreme Court held they could not constitutionally be compelled to do so. The most important single statement in these cases was Mr. Justice Holmes' in *Brooks-Scanlon*, 251 U.S. at 399:

> If the plaintiff [railroad] be taken to have granted to the public an interest in the use of the railroad it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss.[12]

Efforts to distinguish these cases as inapplicable to large railway systems important to the public or to dismiss them as outmoded were rejected by the lower courts in the *New Haven Inclusion Cases, see New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States*, 289 F. Supp. 418, 440-41 (S.D.N.Y. 1968); *In re New York, New Haven and Hartford Railroad*, 304 F. Supp. 793, 802-04 (D. Conn. 1969), *modified and aff'd sub nom. New Haven Inclusion Cases*, 399 U.S. 392 (1970); *New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States*, 305 F. Supp. 1049, 1055 (S.D.N.Y. 1969), *vacated on other grounds sub nom. New Haven Inclusion Cases*, 399 U.S. 392 (1970); by the Third Circuit in the Columbus Option case, *In re Penn Central Transportation Company*, 494 F. 2d 270, 278-82, *cert. denied*, 419 U.S. 883 (1974); by this court on the 180-Day Appeals, 384 F. Supp. at 918-19; and most importantly, by the Supreme Court in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 122 (1974). The transferors claim to be entitled to pre-conveyance CUE from the date of "accrual" of their "*Brooks-Scanlon* rights"; the serious issues are whether these ever did "accrue" prior to conveyance and, if so, when.

The Penn Central Trustees contend that this accrual occurred on October 1, 1973, some three months before the Rail Act was

enacted. They base their claim on the history of the Penn Central reorganization proceedings. In extended summary this history was as follows:

The Trustees contend that Penn Central was in danger of collapse almost from the time it entered bankruptcy on June 21, 1970. On December 22, 1970, faced with an imminent total depletion of working cash, due in part to a retroactive wage increase mandated by Congress on December 10, 1970 in order to halt a nationwide strike, the Trustees petitioned the reorganization court, 325 F. Supp. 302 (E.D. Pa. 1971), for authority to issue $100 million of trustees' certificates to be guaranteed by the United States under the then proposed and shortly thereafter enacted Emergency Rail Services Act of 1970 (ERSA), 84 Stat. 1975. The petition was opposed by the Trustee of the New Haven, who had become a large creditor and stockholder as a result of the inclusion of the New Haven in the Penn Central, *see New Haven Inclusion Cases,* 399 U.S. 392 (1970), the indenture trustees of various mortgages, and stockholder interests. One of the § 77 Trustees testified there was a reasonable prospect that within three to five years the PC would be restored to "viability" in the sense of having some income available for the payment of fixed charges, 325 F. Supp. at 304. The Secretary of Transportation had likewise found, as required by ERSA, that "the railroad can reasonably be expected to become self-sustaining." *Id.* The reorganization court (Judge Fullam) granted the Trustees' petition. He found that this was "not a situation of attempting to require the railroad to be operated permanently at a loss," citing *Brooks-Scanlon*, although "[f]undamental statutory and administrative changes, affecting such matters as rate-making, abandonments or subsidization of uneconomical lines, and labor arrangements, will undoubtedly be required if continued viability of railroads, especially Eastern railroads, is to be assured."

In a report dated February 10, 1971, the Trustees affirmed that the Penn Central could be successfully reorganized if (a) the passenger service was handled in accordance with the principles

of the National Railway Passenger Service Act of 1970; (b) the freight service plant was rationalized; (c) changes were made in the regulation of freight rates; and (d) employment and labor policies were significantly modified. If such "rational terms" were provided, Penn Central could be viable; to the extent they were not, provision must "be made for some different form of compensation for any extra costs incurred for reasons beyond the control of those responsible for the enterprise." The report did not indicate just how, as a practical matter, this largely unprecendented and halcyon solution was to be achieved.[13] Further reports were made in March and September 1971; in the latter the Trustees professed satisfaction "with the time schedule of the reorganization effort thus far," noting they had not yet completed their projections of future traffic levels, which studies were necessary to assess the railroad's viability, asking six more months to test "whether a rational labor pattern can be established," and reporting "substantial progress" in alleviating deficits from passenger service and the launching of an "active abandonment program."[14]

The Trustees made a more comprehensive report on February 15, 1972. They announced that in their judgment "Penn Central *can be* successfully reorganized." (Emphasis in original). They conditioned this prophecy, however, on the attainment of certain forecasts of traffic volume and freight revenues and "the accomplishment of three basic changes in the Penn Central situation which will require action beyond the sole competence of the management, the Trustees, or this Court: rationalization of the Penn Central plant, removal of unnecessary labor costs, and full compensation for continuing passenger service losses." They stressed the importance of consummating a plan before continued operations "so erode the Debtor's estate as to be either practically or constitutionally impermissible." They concluded by saying:

> It should be possible for Federal, state and local governments and all interested parties to analyze the situation as

> presented in this Report and to come to conclusions as to whether they are prepared to cooperate in achieving the changes necessary to allow the Penn Central to continue as a private enterprise. If an adequate response should not be forthcoming, the Trustees will be prepared to advise the Court that this reorganization proceeding is producing a result for which Section 77 was not intended and could not constitutionally have been intended. We do not expect that default.[15]

The Chairman of the Interstate Commerce Commission wrote the reorganization judge that the report constituted

> in effect, clear notice to the public that the Penn Central cannot be reorganized successfully in the manner normally contemplated by section 77 of the Bankruptcy Act. What the trustees are telling us, in short, is that assistance must be forthcoming from the National government, from State and local governments, from shippers and receivers of freight, from passengers, from railroad employees, and from all others who will benefit by continued Penn Central operation if the railroad is to survive. We agree, and we commend the trustees for their candor and for their realistic approach.

On April 1, 1972, the Trustees filed a plan of reorganization expected to become realizable in 1976. This plan proceeded on the assumption that PC's earned income available for fixed charges would reach $275 million by 1976, failing which the plan would be withdrawn. On the effective date of the plan, PC was to be authorized to abandon any uneconomic lines whose operating losses had not by then been covered through contractual arrangement or a subsidy policy, and to terminate any passenger service for which it was not fully compensated; in addition, the plan noted the importance of meeting the railroad's projected increase in freight revenues and in reducing labor expenses. The Trustees

defended their proposed abandonment program against the complaints of some creditors by noting that 11,000 miles of track had been identified as the "freight core" of a reorganized system; these lines had generated 80 percent of the PC's freight operating revenues in 1970, although studies of the projected operating results of such a cutdown system for 1972-1976 were expected to take until September 1972. Noting the New Haven Trustee's criticism of the reorganization plan, that

> [e]ven if an income plan could be devised which carried the hope of some interim success by 1976, the adverse characteristics of the Penn Central system service area . . . flash all the signs of the New Haven's own prior experience. The New Haven was "successfully" reorganized in 1947 after a proceeding which began in 1938, only to become bankrupt again in 1961.

the Trustees replied that they believed that

> given reasonable time and help from others . . . viability will be established, and Penn Central will emerge as a strong carrier with sufficient earning power to operate with confidence in the future.

On October 1, 1972, the Trustees reported that their studies indicated that a 15,000 mile freight core system could produce $243 million income available for fixed charges in 1976, assuming the usual four requisites were substantially attained; this larger system seemed more profitable than an 11,000 mile system because of labor expenses which could be only gradually reduced. The Trustees also discussed possible alternatives to a conventional private income-based reorganization, including public assistance to supply operating costs or capital needs, but noted that this discussion was "not a position of pessimism but one of prudence so that the Court, the public and all interested parties may begin to consider the alternatives."

Appendix C

The Trustees' Interim Reports of January 1 and February 1, 1973 struck a new note. In addition to the three types of outside assistance outlined in the report of February 15, 1972, the Trustees now considered that the Penn Central would require government aid in the range of $600-$800 million. This need was due to two principal factors — delays in realizing some of the goals set in the Trustees' earlier reports, with consequent increase in priority claims, and realization that attainment of the traffic and revenue projections required larger expenditures for modernization of plant. The February 1 report again took note of the large savings that would result from changing the existing 20,000 mile railroad (with gradual abandonments down to 15,000 miles) to an 11,000 mile railroad,[16] and acknowledged that "[s]trong arguments can and will be made that immediate action to relieve Penn Central of the foregoing excessive service and labor obligations is the best course to follow." The Trustees rejected these arguments as impractical, instead looking to the projected but wholly unpromised government aid.[17]

In early February 1973 the Trustees, having exhausted procedures under the Railway Labor Act, made a reduction in the size of train crew consists. This resulted in a strike of operating employees on February 8. Congress stepped in with a Joint Resolution, P.L. 93-5, 87 Stat. 5, approved February 9, 1973. Taking note of the Trustees' views that "a massive infusion of Federal financial assistance would be needed" in any event and that cessation of PC's operations even for a short period "may make it financially impossible to resume operations," Congress imposed a three-month freeze on the implementation of crew consist changes and directed the Secretary of Transportation to submit, within the short period of 45 days, a report which "provides a full and comprehensive plan for the preservation of essential rail transportation services in the Northeast section of the Nation. . . ."

These developments led the reorganization court to issue a Memorandum and Order on March 6, 1973, *In re Penn Central*

Transportation Company, 355 F. Supp. 1343 (E.D. Pa. 1973), "charting a future course for the reorganization proceeding which will be consistent with legal and constitutional requirements." Dealing with the question of erosion, the court said, *id.* at 1344,

> the record justifies the conclusion that post-reorganization deferrals and unpaid administration claims have already eroded the Debtor's estate to the extent of about $500 million. . . . Under any view of the matter, it seems clear that the point of unconstitutionality is fast approaching, if it has not already arrived.

Judge Fullam concluded, *id.* at 1346,

> I take judicial notice of the fact that the legislative and executive branches are now addressing themselves to these problems. . . . It would obviously be premature, therefore, for this Court to make final determinations as to the future course of this reorganization proceeding on the basis of the existing legislative and regulatory framework. The legal and constitutional rights of the parties to this reorganization should be evaluated in the light of whatever changes Congress sees fit to enact.
>
> By the same token, however, this Court cannot ignore the realities of the Debtor's situation. On the basis of the record to date, it appears highly doubtful that the Debtor could properly be permitted to continue to operate on its present basis beyond October 1, 1973.
>
> Under the circumstances, I have concluded . . . that a further hearing should be held on July 2, 1973, to permit a careful and realistic re-evaluation of the situation in the light of intervening events. At that hearing, the Trustees will be required to file either a feasible plan for reorganization of the Debtor, or their proposals for liquidation or other disposition of the enterprise.

Appendix C

Under the legislative prod of the Joint Resolution of February 9 and the judicial prod of Judge Fullam's opinion of March 6, 1973, Secretary of Transportation Brinegar submitted his report to Congress on March 26, 1973. It was a remarkable document, containing the gist of what was to become the Rail Act some nine months thereafter. The report proposed sweeping legislative reforms that would permit identification of necessary core rail services in the Northeast, streamlined procedures for abandonment of unnecessary lines, and formation of a new corporation to operate the redesigned system. The report stressed that "the time for action is short," calling attention to the hearing set by Judge Fullam for July 2 "to hear proposals either for a workable plan or the trustee's blueprint for liquidation," which would be "the Court's only legal recourse" if no plan was forthcoming. On the other hand, the Secretary thought that if Congress "acts expeditiously along the lines outlined in this report, we believe that the Court will have an alternative to liquidation that is better for all concerned and for the Nation as a whole." The Secretary promised promptly to submit proposed legislation.[18]

Congress speedily initiated hearings to consider proposals made by the Secretary and others. On June 21, 1973, Senator Magnuson, Chairman of the Senate Commerce Committee, Senator Hartke, Chairman of the Sub-committee on Surface Transportation, and Representative Staggers, Chairman of the House Interstate and Foreign Commerce Committee, joined in a letter advising Judge Fullam that the appropriate Congressional committees had "begun consideration of a number of legislative proposals which would, if enacted into law, provide relief to the railroads in bankruptcy proceedings in the Northeast" including "varying degrees of federal assistance in solving the crisis which now exists." The legislators expected action by Congress "sometime this summer or early fall."

On July 2, no legislation having been adopted, the PC Trustees requested authority from the reorganization court to submit to the ICC what was called a plan of reorganization. Under the

plan, if aid from the federal or local governments or other sources to compensate for continued erosion was not forthcoming by October 1, all freight and passenger service was to cease on a schedule estimated at 10 weeks. The Trustees would temporarily preserve all assets which might be required if provision for continued rail services were to be made. During the first six months after approval of the plan, the Trustees would consider only those offers to purchase or lease rail properties that committed the offeror to continue or resume rail service; acceptance of any such offer was subject to approval by the court and the ICC.[19] After the end of the six-month period, rail assets for which no such offers had been made or for which such offers had been disapproved, would be scrapped and underlying real estate sold or otherwise disposed of, "unless the Court shall find that a particular sale can reasonably be expected to impair the ability of the Commission to approve the Completed Plan of Reorganization for the Debtors." The Trustees might dispose of non-rail assets at any time, subject to the same condition. Thereafter, on a date nine months from approval of the plan,

> the Trustees and the Debtors shall be relieved of all common carrier obligations in respect of all rail lines and operations of the Debtors, any state law or regulation to the contrary notwithstanding, including operations over all lines of railroad leased from corporations whether or not 50 percent of the voting stock is controlled directly or indirectly by the Debtors.

The liquidation was subject to a proviso, noted above, that,

> If the Court shall, prior to October 1, 1973, have approved arrangements pursuant to which relief is forthcoming from the United States, other government authorities, or other sources to stop the erosion of the Debtors' estates, Penn Central shall continue to provide rail services in the

manner approved by the Court for a period not to exceed 12 months from the date of such approval.

Overruling objections of stockholder interests and others which sought a 90-day extension of referral of the plan to the ICC in view of the pending legislative consideration, the court authorized submission of the Trustees' plan, and requested the ICC "to certify an approved plan of reorganization, or a preliminary step thereof" not later than October 1, 1973. *In re Penn Central Transportation Company*, 363 F. Supp. 1263, 1267 (E.D. Pa. 1973).[20]

On September 28, 1973, the ICC filed its report rejecting the Trustees' and other plans. *Penn Central Transportation Company Reorganization*, 347 I.C.C. 45. A principal ground, probably erroneous,[21] was that a plan which provided for the sale of rail properties without assuring continued rail service was not cognizable under § 77. *Id.* at 79-85. On the other hand, the Commission was correct in pointing out that rejection of the plans left the court free to dismiss the reorganization proceeding pursuant to § 77(g). *Id.* at 85.

At a hearing before the reorganization court on October 12, the Interstate Commerce Commission, the Under Secretary of Transportation and, in a later submission, the Department of Justice urged that, in view of the progress being made in Congress to develop new legislation, the court should not dismiss the reorganization proceedings, as the New Haven Trustee had requested,[22] but should fix a date for a later hearing. Although expressing some impatience at the delay, Judge Fullam deferred action on the proposals to dismiss the proceedings "pending action by Congress on the Rail Act." *See In re Penn Central Transportation Company*, 382 F. Supp. 856, 861 (E.D. Pa. 1974). The latter became law on January 2, 1974.[23]

The scheme of the Act is described in detail in our opinion on the 180-Day Appeals, 384 F. Supp. at 904-10, and there is no need to repeat that here. It suffices at this point to say that the

Rail Act required that the United States Railway Association (USRA) submit to Congress within 450 days a final system plan (FSP) providing for the conveyance to the Consolidated Rail Corporation (ConRail) or to solvent railroads of designated rail properties of those bankrupt estates which were not reorganizable on an income basis; that the FSP should be deemed approved by Congress unless within 60 calendar days of continuous session after submission, either house of Congress passed a resolution of disfavor (in which event USRA was to submit a revised plan to which similar procedures would apply); and that conveyances should take place within 110 days after the FSP became effective. This expeditious program was altered in only two significant respects. Because of delay by President Nixon in appointing the board of USRA, Congress extended the date for the submission of the FSP from 450 to 570 days, 88 Stat. 1464. The FSP, a most impressive document on any view, was submitted on July 26, 1975. Neither house of Congress exercised a veto, and the FSP became effective on November 9, 1975. Meanwhile it had become apparent that the Rail Act required amendment in many particulars. Congress embodied these amendments in Title VI of the Railroad Revitalization and Regulatory Reform Act of 1976, 90 Stat. 31. This approved the FSP as modified by USRA's supplemental report dated September 18, 1975 and the official errata supplement dated December 1, 1975; permitted certain further designations to be made within 20 days; and fixed March 12, 1976 as the date for delivery by USRA to this court of a certified copy of the FSP with a resulting conveyance date of April 1.[24] The conveyances were made effective as of 12:01 a.m. on April 1, 1976; concededly any erosion of the conveyed properties ended at that time.

III. The Authorities

The recent recognition of the continued vitality of *Brooks-Scanlon* and its two companion cases, to which we have referred,

should not obscure how limited those holdings were. The sole issue was the right of a railroad conceded to be a hopelessly losing one to cease operations rather than be obliged to continue indefinitely. There was no issue whether the railroad must first comply with applicable regulatory procedures before it became constitutionally entitled to stop operating.[25] Still less was there any suggestion that the railroads, or others like them, were entitled to be paid by the respective states for losses suffered between the time when they first manifested a desire to cease operations because of their losses and the date when operations ceased. The decisions simply upheld the claims of the railroads that they were entitled to cease operations as against the claims of state administrative agencies which were insisting on their continuance with attendant penalties for refusal to obey; the evident thought was that the owners' remedy for any wrongful action by administrative bodies lay in the courts.

Neither *Brooks-Scanlon* nor the two later cases raised a question concerning another related factor present in these proceedings — the responsibility of a bankruptcy court to bring a reorganization proceeding to an end if all hope of success has faded. Here the seminal case is Judge Frank's opinion in *In re Third Avenue Transit Corp.* v. *Lehman,* 198 F.2d 703 (2 Cir. 1952). This dealt with an application by the trustees of a local transit company in reorganization under Chapter X of the Bankruptcy Act to compel an indenture trustee to turn over proceeds from the sale of mortgaged assets for use in continuing operations. The court of appeals held that, in deciding to grant the application, the district court had not imposed sufficiently stringent tests of the necessity of obtaining the funds and their unavailability from other sources, and of the likelihood of successful reorganization so that the secured creditors would not suffer harm merely to benefit junior claimants. The court said, 198 F.2d at 707:

> There are strict limits to the extent to which, in reorganization proceedings, the interests of creditors (or of a particular class of creditors) may be sacrificed to the public interest; to exceed those limits is (to say the least) to come dangerously close to the edge of unconstitutional taking of property, a line from which courts should keep away if possible. The reorganization judge should not compel a marked sacrifice of that kind, without first deciding, on substantial evidence, whether the interest of the creditors who would be affected by the sacrifice does not demand that prompt steps be taken to bring about abandonment of the utility's operations, including steps to procure the consent of those public authorities (if any) whose consent to abandonment is required. (Footnote omitted.)

There was no suggestion that the Chapter X trustees could ignore public authorities "whose consent to abandonment was required," still less that anyone was bound to pay for losses incurred while this was being obtained.[28]

The more recent line of cases begins with a statement in *Penn Central Merger and N&W Inclusion Cases*, 389 U.S. 486, 510-11 (1968). The Court there rejected a contention of some New Haven bondholders that, because of the erosion of the property of the New Haven, the Penn Central merger should be permitted to be consummated only if the New Haven were fully protected against further erosion. Mr. Justice Fortas said:

> While the rights of the bondholders are entitled to respect, they do not command Procrustean measures. They certainly do not dictate that rail operations vital to the Nation be jettisoned despite the availability of a feasible alternative. The public interest is not merely a pawn to be sacrificed for the strategic purposes or protection of a class of security holders whose interests may or may not be served by the destructive move.

Appendix C

New Haven Inclusion Cases, 399 U.S. 392 (1970), is the only case prior to the Rail Act in which a claim of entitlement to payment for something resembling unconstitutional erosion was pressed. While both sides rely heavily on this decision, in our view its import for these proceedings is considerably less than asserted by either.

While the Supreme Court denied the claim of the New Haven bondholders that the price to be paid by the Penn Central must include erosion of the New Haven's property for the five years before the valuation date, December 31, 1966, or at least for the two years between that date and actual inclusion, 399 U.S. at 492-93, and some language in the opinion is favorable to the Government parties, the circumstances were quite different than here. The claim was being asserted not against the United States as having compelled continued operations but against a private company. Whoever was responsible for the New Haven's continuing in reorganization for seven years before inclusion in the Penn Central system, it was surely not the components of the Penn Central, which would have been pleased at all stages of the proceeding if the New Haven had simply gone away. Indeed no one had been responsible for the New Haven's continued operation in any blameworthy sense. The reorganization judge, Judge Anderson, had been acutely conscious of his responsibility to prevent a wastage of the assets of the New Haven security holders and had manifested his displeasure at the failure of state governments to be more constructive, *see In re New York, New Haven and Hartford Railroad*, 304 F. Supp. 793, 800-01 (D. Conn. 1969); *New Haven Inclusion Cases*, 399 U.S. at 465 n.72; he later stated that but for the prospects of inclusion of the New Haven in the Penn Central, he would have ordered abandonment applications to be filed in late 1963, 304 F. Supp. at 801. The Trustees of the New Haven and almost everyone concerned with it had seen the Penn Central merger as both a peril and a promise, *see In re New York, New Haven and Hartford Railroad*, 378 F.2d 635, 636 (2 Cir. 1967), a peril because the merger would cause

substantial diversion of traffic from the New Haven to the Penn Central and a promise because § 5(2)(d) of the Interstate Commerce Act empowered the ICC to insist on the New Haven's inclusion as a condition to approving the merger. The prospect of receiving marketable securities of what was widely heralded as a railroad with prospects of high financial success[27] was far more attractive than the uncertainties of liquidation in a region deprived of what had been its major rail carrier. Moreover, as the Supreme Court noted, 399 U.S. at 493, no application to the reorganization court to dismiss the reorganization proceedings and thus permit foreclosure of the mortgage liens was made until April 1967. As the Court said:

> [T]he failure of the bondholders to press for early liquidation of the New Haven meant that their initial application for a dismissal of the reorganization proceedings came just as the objective of salvaging the New Haven appeared possible to achieve. As the reorganization court noted, only two of the several bondholder groups made that initial application; it was not joined by the trustees, nor was it endorsed by other representatives of the bondholders and creditors; and it came just as the Commission was about to certify a feasible plan of reorganization to the court.

Thus, the Supreme Court's approval of the erosion burden placed on the New Haven's estate would not be conclusive in a situation in which it was determined that the railroad or its bondholders had sought early dismissal of the reorganization proceeding or applications for abandonment and their claim for compensation lay against the government rather than an acquiring railroad.

On the other hand, we do not consider the Supreme Court's rejection of the proposal made by the ICC in its Fourth Supplemental Report, 334 I.C.C. 25, 58-60 (1968), that the liquidation value of the New Haven as of December 31, 1966, should be reduced by custodial costs, real estate taxes and discount for a

year, which the Commission assumed would been required to obtain a certificate of abandonment, to be so helpful to the transferors' claims to pre-conveyance CUE as they contend. Indeed, it cuts rather the other way. The Court said of the dispute between the Commission and PC on the one hand and the bondholders on the other, 399 U.S. at 461:

> It does not draw into question the right of the Commission to insist that New Haven obtain permission to abandon its operations: no one here quarrels with the proposition that in the event of a liquidation, New Haven would have been obliged to obtain a certificate from the Commission pursuant to § 1(18) of the Interstate Commerce Act. The parties agree that since a delay occasioned by abandonment proceedings before the Commission, followed by judicial review, inheres in the liquidation process, the Commission may exercise its expertise in gauging the extent and expense of such a delay, and Penn Central need not pay for the consequent diminution in the value of the assets of the debtor.

The Court rejected the proposed adjustment essentially because it amounted to double counting.[28] The Court accepted, 399 U.S. at 463, Judge Anderson's finding that the valuation date, December 31, 1966, represented not the date when he would have authorized the New Haven Trustees to seek a certificate of abandonment but the date when they would have had one, since he would have directed application to be made late in 1963 if the solution of inclusion in the Penn Central, far preferable in the public interest, had not been available. Here there is no showing that anyone before 1973 asked the PC reorganization court to require the Trustees to seek abandonment or sale of the PC,[29] nor was there any point before 1973 when the reorganization judge concluded,

as did Judge Anderson in 1963, that the railroad was not reorganizable on an income basis and that the reorganization proceeding would be continued solely to allow alternative arrangements to be worked out.[30]

Continuing with the authorities, we next encounter *In re Central Railroad of New Jersey*, 485 F.2d 208 (3 Cir. 1973) (en banc), *cert. denied*, 414 U.S. 1131 (1974). Dealing with a railroad that had been in reorganization since 1967 with substantial operating losses in each year, *see* 485 F.2d at 22 n.18 (dissenting opinion) and a continuing erosion of assets estimated at $1 million per month, *id.* at 226, the court put the following question, *id.* at 209:

> May a district judge presiding over a railroad reorganization, pursuant to Section 77 of the Bankruptcy Act, permit the Trustees of the railroad to discontinue a loss-producing service or must he withhold his authorization until the Trustees have applied to federal or state regulatory agencies for permission to terminate the service? (Footnote omitted).

The majority answered that the Trustees must at least apply. "There having been no application made, there can be no showing that delay or frustration would be the inevitable result," 485 F.2d at 213 (footnotes omitted).[31]

In our decision on the 180-Day Appeals, we said that while the *Brooks-Scanlon* doctrine remained unimpaired, it had been qualified in two ways. We described the qualification here pertinent as follows, 384 F. Supp. at 919:

> This is that liquidation cannot commence until public bodies, acting under statutory authority, have had a reasonable opportunity to consider and act upon the proposed abandonment, as § 77(*o*) prescribes with respect to the ICC. This is true even when the Constitution requires that a certificate of abandonment must ultimately issue,

> since such proceedings give other parties, notably public authorities, a final opportunity to come up with plans that may prevent serious injury to the public interest.

Finally, there is the brief discussion in *Regional Rail Reorganization Act Cases*, 419 U.S. at 122-25. The discussion was directed mainly to showing the need for determining the applicability of the Tucker Act. It says only that the processes of the Rail Act, especially the possibility noted in the Government's reply brief in the Supreme Court, that "Congress could, in theory, successively disapprove several proposed final system plans," 419 U.S. at 123, might result in an erosion taking, not that they would.

It scarcely needs to be added that enactment of the RRRRA, which authorizes this court to take account of compensable unconstitutional erosion, carried no implication that Congress thought this had occurred and affirmatively desired us to make a pre-conveyance CUE award. Such thoughts as Congress had, while of course not binding us with respect to constitutional questions, were to the contrary. *See* Senate Conference Rep. No. 595, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., January 28, 1976) (clerical corrections):

> Considering substantial benefits conferred by the Rail Act it seems unlikely that any alleged compensable unconstitutional erosion arising from the operation of the Rail Act will be provable. . . . There is no intention even remotely to imply that there may be merit in a claim for pre-Act erosion, or indeed for any erosion.

IV. WHEN DID CUE BEGIN TO ACCRUE—IN GENERAL AND WITH RESPECT TO THE PENN CENTRAL

The PC Trustees do not dispute that the mere fact that a railroad, even one in reorganization is in a hopelessly losing position does not entitle it to quit operations immediately in the face

of statutes requiring approval of such cessation by federal or state regulatory agencies; they concede there is no "taking" until government has had a reasonable opportunity to make alternative arrangements for the carrying on of such public service as is found to be needed. Their position rather is that government—both federal and state—was placed on notice of the PC's plight as early as the Trustees' report of February 10, 1971; that the period of some 32 months from then until October 1, 1973, was more than a reasonable time for government to develop solutions; and that an erosion taking began on that date. The Government parties answer that the early reports of the PC Trustees were nowhere so foreboding as they now assert; that the Trustees made few proposals sufficiently definite to call for action by an agency of the Government and did not pursue the proposals in appropriate proceedings; that despite all the general talk about need for rationalization of plant the PC Trustees made no applications to the ICC for large-scale abandonments;[32] that no application to dismiss the reorganization proceedings was ever made by them and no such application was made by anyone else until the New Haven Trustee's application of October 9, 1973; that the first clear intimation that the reorganization of PC on an income basis would require infusion of federal funds was not made until January 1, 1973 and not quantified until February 1, 1973; and that even if the events of February and March 1973 were to be taken as starting the clock running for a responsible governmental answer—and they insist that no earlier date could reasonably be found—the federal government acted with speed that was not merely reasonable but remarkable in light of the complexities of the situation, with the result that PC was relieved of its common carrier responsibilities far sooner, and on a much more advantageous basis, than if the Trustees had filed applications for abandonment or sales in the winter of 1973 and ultimately had to endeavor to dispose of PC's rail properties.

Our first observation is the obvious one that a § 77 trustee is as much subject to § 1(18) [now slightly amended as § 1a(1)] of

the Interstate Commerce Act forbidding abandonment of a line of railroad or the operation thereof without approval of the ICC as the railroad itself would have been. *Smith* v. *Hoboken Railroad, W&S Connecting Company,* 328 U.S. 123, 130 (1946). We assume the same is true under most state regulatory statutes. *Cf. Palmer* v. *Massachusetts,* 308 U.S. 79 (1939).

A second observation is that § 1(18) requires Commission approval for a voluntary cessation of all operations which is intended to be permanent and not merely for the tearing up of a line. The statute speaks of abandonment either of "all or any portion of a line of railroad" or "the operation thereof"; if the disjunctive language left any room for doubt that voluntary cessation of all operations on a basis intended to be permanent constitutes an abandonment, *Smith* v. *Hoboken Railroad, W&S Connecting Company, supra,* 328 U.S. at 130, and *Thompson* v. *Texas Mexican Railway,* 328 U.S. 134, 144-45 (1946), would remove it.

A third proposition is that § 1(18) does not cease to be applicable merely because serious erosion of the property of a railroad is taking place. As indicated, the railroads in *Brooks-Scanlon, Bullock,* and *Eastern Texas* had been through all administrative processes that were required. Despite the desperate situation of the New Haven, which had experienced net operating losses for four and a half years before invoking § 77, *see New York, New Haven, and Hartford Railroad Discontinuance of Trains,* 327 I.C.C. 151, 166 (1966), and by 1963 had no prospect for a successful reorganization on the basis of capitalized earnings, *see In re New York, New Haven and Hartford Railroad,* 289 F. Supp. 451, 456 (D. Conn., 1968), Judge Anderson considered that authorization to abandon would have had to be obtained from the Interstate Commerce Commission, *In re New York, New Haven and Hartford Railroad,* 304 F. Supp. at 801;[33] as shown above, the Supreme Court rejected the Commission's proposal to take account of an additional year to obtain such authority not because it thought that this was not needed, but because Judge

Anderson had already taken into account a reasonable period for obtaining it. 399 U.S. at 463. Again, as noted in Section III of this opinion, our own decision on the 180-day Appeals held that the *Brooks-Scanlon* principle had been qualified by requiring compliance with reasonable requirements for administrative approval; perhaps it would have been more accurate to say that the *Brooks-Scanlon* doctrine needed no such qualification since the administrative process had been exhausted in that case and its two early companions. *See also New York, New Haven and Hartford Railroad First Mortgage 4% Bondholders' Committee* v. *United States,* 305 F. Supp. at 1055; *In re Central Railroad of New Jersey,* 485 F.2d at 215. The validity of this third proposition is in no way impaired by decisions, stemming from the *Third Avenue Transit* case, *supra,* 198 F.2d 703, that a reorganization court cannot properly impair liens by such measures as approving the issuance of trustee's or receivers' certificates or authorizing use of the proceeds of sale of mortgaged properties for operations when the prospect of successful reorganization has disappeared, but instead must direct a trustee to apply for abandonment.

Apart from authority we see no basis in principle for holding that application of the abandonment provisions of § 1(18) to a debtor for whom a successful § 77 reorganization is no longer possible constitutes a taking of the portion of the estate eroded during a reasonable period required to obtain the needed abandonment authority in a proceeding which enables the Government to explore and develop alternative solutions. Although there is "no set formula to determine where regulation ends and taking begins," *Goldblatt* v. *Town of Hempstead,* 369 U.S. 590, 594 (1962), *see Pennsylvania Coal Company* v. *Mahon,* 260 U.S. 393, 416 (1922); Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1249 (1967); Ackerman, Private Property and the Constitution 244 (1977), we have no doubt that requiring even a hopelessly losing railroad to obtain

administrative permission for abandonment falls on the regulatory side. The building and operation of a railroad are not merely an added service to persons already on the scene so that its withdrawal would leave them no worse off than they were before. The railroad attracts more people and more investment on the justified expectation that service will continue. As was eloquently said in *The Minnesota Rate Cases*, 230 U.S. 352, 452 (1913), in a somewhat different context:

> The railroad has long been established; to it have been linked the activities of agriculture, industry and trade. Communities have long been dependent upon its service, and their growth and development have been conditioned upon the facilities it has provided. The uses of property in the communities which it serves are to a large degree determined by it. The values of property along its line largely depend upon its existence. It is an integral part of the communal life.

Those who invest in a railroad in the face of statutes prohibiting abandonment without administrative approval do so with the knowledge that operation cannot cease immediately merely because it has become unprofitable and the investors might be better off if the railroad were liquidated forthwith. To be sure, no matter how profitable it may have been in the past, a railroad cannot be compelled to operate indefinitely at a loss. But Congress may constitutionally require, without thereby engaging in a taking, that operations continue until a certificate of abandonment has been obtained through proceedings conducted by an administrative agency with reasonable promptness.

A fourth proposition is that when Congress has specified a particular procedure, namely, application to the ICC, for obtaining authority to abandon, a railroad or its trustee cannot opt out from the statutory requirement in favor of other procedures which they consider just as good. We therefore reject the

argument that interim reports of the PC Trustees, some more gloomy, some less so, served the office of applications to abandon and started the running of the clock for the Government to make an effective response. An application to abandon all or a large part of the operations of the Penn Central would have constituted sharp notice both to the tribunal designated by Congress to exercise "fostering guardianship and control" over the railroads, *Dayton-Goose Creek Railway* v. *United States*, 263 U.S. 456, 478 (1924), and to Congress itself, altogether different in nature and probable effect from reports of the PC Trustees to the reorganization court even though the reports were fully known to the Interstate Commerce Commission. The Commission is legally bound to act on applications filed with it, not on conditions made known to it, however desirable that might be. It simply will not do to say that the condition of the bankrupt railroads in the Northeast had reached such a pass that the ICC was no longer a factor. Section 1(18) of the Interstate Commerce Act stood in the early 1970's as it had since 1920, and the PC Trustees were not relieved of compliance by their view that the crisis called for action beyond the Commission's powers.[34] We reaffirm the statement in our opinion in the 180-Day Appeals that "even when the Constitution requires that a certificate of abandonment must ultimately issue, . . . such proceedings give other parties, notably public authorities, a final opportunity to come up with plans that may prevent serious injury to the public interest." 384 F. Supp. at 919. Among such "public authorities" is the Government of the Unites States. If the PC Trustees had applied to the Commission for authority to abandon in 1971 or 1972, the Rail Act might have been enacted and the conveyances consummated much sooner. They are not entitled to be treated as if they had done what, for one reason or another,[35] they failed to do.

Passing for the moment the important issue of "cashlessness," we therefore cannot accept the oft-iterated claims of the PC and other trustees that, as they put it, their "*Brooks-Scanlon* rights" had "accrued" by October 1, 1973, and *a fortiori* by January 3,

1974, so that despite the absence of proceedings seeking authority to abandon, any further operations must be deemed to have been for the account of the federal government. The error in this contention is that nothing in *Brooks-Scanlon* or any other decision of the Supreme Court or of this court indicates that a right to cease operations "accrues" to a losing railroad until it has complied with reasonable requirements for obtaining administrative approval of abandonment.

On the other hand, we believe enactment of the Rail Act should be taken as relieving the various trustees from any further obligation to apply for leave to abandon. As we pointed out in our decision on the 180-Day Appeals, 384 F. Supp. at 920-21, § 304(f) [now § 304(h)] prohibited abandonments unless authorized by USRA and "unless no affected State or local or regional transportation authority reasonably opposes such action," a standard which would permit few, if any, abandonments.

Indeed, we think there is justification for placing somewhat earlier the date when the various trustees (other than those of the Erie Lackawanna, *see* Section V(F), *infra*) should be treated *prima facie* as if they had applied for abandonment. The trustees argue with force that the prospect of federal legislation during the last three quarters of 1973 made it idle for them to seek authority to apply for extensive abandonments and for reorganization courts to act on such petitions for leave to cease service as were presented to them, and also had an adverse impact on plans to make other dispositions of the properties. *See New York, New Haven and Hartford Railroad 4% Bondholders' Committee*, 305 F. Supp. at 1055-56.

To be sure, there is some inconsistency in the Trustees' saying on the one hand that Congress had a duty to act with respect to the railroad problem in the Northeast and on the other that its doing this in a careful and responsible way enhanced the liability of the United States for erosion claims. It could hardly be expected that the Rail Act would spring, like Athena, from the

head of Zeus. The adverse effects of the nine months of legislative discussion, surely not an unduly long period for a measure as complex as the Rail Act, can be viewed as simply the price which the security holders of the bankrupt railroads must pay for living in a democratic society.[36]

However, the law does not compel the doing of a futile act and we are convinced that after Congress, on February 9, 1973, called on the Secretary of Transportation promptly to submit a report which "provides a full and comprehensive plan for the preservation of essential rail transportation services in the Northeast section of the nation," it was unrealistic to expect that a reorganization court would have authorized an application for large-scale abandonment — although Judge Fullam's order authorizing the PC Trustees to submit their reorganization plan to the ICC came close to that, or that the Commission would have devoted its resources to the processing of such an application. However, this means only that the PC Trustees and, in the absence of evidence pointing to a contrary conclusion, the trustees of other lines are to be treated as if they had *applied* for abandonment in February 1973 — not as if during 1973 they had been denied permission to abandon or been forced to operate despite such permission.

We are convinced that in the case of the Penn Central it would have been impossible to complete abandonment proceedings before April 1, 1976, even if applications for all of Penn Central's trackage had been filed in February 1973 and the Commission had treated the applications, as it should have, as deserving the highest priority. Here was a railroad of more than 19,000 miles, operating in 14 states and the District of Columbia and having 1972 transportation revenues of $1,825,000,000. In our opinion on the 180-Day Appeals we reviewed the practical obstacles to the swift obtaining of permission for any large-scale abandonments, including those resulting from the need for the Commission's staff to prepare environmental impact statements, and

concluded that "the chance of favorable action by the Commission on any large-scale abandonments within 620 days would have been exceedingly poor." 384 F. Supp. at 922. We now know that the situation would have been far more complex than we had envisioned in 1974 since it appears from the submissions made to us in other phases of this case that the PC Trustees would have sought approval of sales to other railroads and to state transportation authorities,[37] as well as abandonments. Sales to other railroads would have given rise to considerations of competitive effect which, with the best will in the world, would have taken many months of hearings and briefings to explore. We thus are confident that even if an application for permission to abandon had been filed in February 1973, it would have been impossible for the PC Trustees to have obtained authority to dispose — not to speak of actually disposing — of a major portion of the rail properties conveyed on April 1, 1976 prior to that date.[38] The fact that formulation of the Rail Act and elaboration and consummation of the FSP took the time that they did is almost sufficient proof of this. Neither Congress nor USRA was obliged to comply with NEPA or the Administrative Procedure Act, as the Commission would have been. Our concern in the 180-Day Appeals with respect to erosion was not over such a period, but over what then seemed a very real probability that at least one house of Congress would veto the initial version of the FSP, with consequent long delay while a revised plan was being formulated and resubmitted, 384 F. Supp. at 922, 925,[39] and a correspondingly long postponement of the conveyance date. This did not occur.

There is one important but limited caveat to our finding that abandonments of PC properties would not have taken place before April 1, 1976 even if applications had been filed early in 1973 and the Commission had proceeded with all possible diligence. While arguing that in general there was no pre-conveyance CUE, the Government parties suggested that we leave it open to the smaller railroads to attempt a showing that but for

enactment of the Rail Act (to which we add the previous nine months of debate), they would have sought and could have obtained authority to abandon or transfer all their operations prior to the conveyance date and would have done so. Fairness seems to require that this opportunity be open to all transferors — not only to the smaller carriers, discussed in Section V *infra*, but also to the PC Trustees, and not only with respect to the whole of their operations but to truly significant parts.[40] Subject to the comments in Section VI of this opinion, we will allow such showings to be attempted.[41]

We say "attempt" since we agree with the Government parties that in view of the interdependence of the various railroads in the Northeast, the burden of demonstrating the probability of obtaining a final decision on and consummating major abandonments or sales before April 1, 1976, even with an assumed filing date as early as the winter of 1973, will be extremely heavy. In a non-Rail Act world, where the ICC would presumably have been faced with a request for abandonment or sale of thousands of miles of track from the Penn Central, not to speak of similar requests by other transferors, the difficulties in providing expedited settlement for any large number of lines would have been extremely grave. The solution which the ICC would have had to devise to the regional rail crisis would have involved a complex piece of regional planning, and we think it unlikely that the ICC would have tied its hands early in the proceedings by permitting abandonment or sale of major lines even before it knew what shape the surviving system might take. The abandonment application of a single line, even though it was a clearly losing operation, would often have significance for other abandonment applications. For instance, while an abandonment of line *X-Y* by bankrupt railroad *A* might be a clear case if service between *X* and *Y* were assured over bankrupt railroad *B*, the situation would stand different if bankrupt railroad *B* also was seeking abandonment authority. In such a case, the Commission would have had to consider whether one of the roads might be able to operate

profitably if relieved of competition by the other, and also to explore the possibility of obtaining service in other ways, whether through acquisition by another carrier or through sale to or subsidy by government. We thus find it likely that the abandonment or sale proceedings in the hypothetical world without a Rail Act, even if they began with separate applications by the various bankrupt railroads, would have involved a consolidated planning process very much like that engaged in by USRA in formulating the Final System Plan but with more time-consuming hearing requirements.

We thus come to the point we have passed so far. This is the contention of various trustees that but for the Rail Act, with its provisions, §§ 213 and 215, designed to keep the bankrupt carriers financially alive while the FSP was being formulated by USRA, submitted to Congress, and implemented, they would have run out of cash and would have been entitled to cease operations on that ground without federal or state administrative permission. Reliance is placed on footnote 31 to our opinion on the 180-Day Appeals, 384 F. Supp. at 919, saying that we assumed there would be no need to obtain approval of abandonments "if, after all reasonable efforts, a reorganization trustee was faced with an imminent depletion of cash that would make it impossible for him to pay current bills for wages, supplies, interline balances, and similar expenses, and still leave an amount sufficient to permit an orderly liquidation." This assumption rests on the basis that a carrier does not "abandon" what it is simply unable to do. *Zirn* v. *Hanover Bank*, 215 F.2d 63 (2 cir. 1954); *ICC* v. *Chicago, Rock Island and Pacific Railroad*, 501 F.2d 908, 911 (8 Cir. 1974), *cert. denied*, 420 U.S. 972 (1975).

The PC Trustees contend that but for the Rail Act they would have reached this point of "cashlessness" in February 1974. In fact, that did not occur in their case or any other because a combination of the carriers' own resources and $557 million in Government funds provided under §§ 213 and 215 of the Rail

Act[42] prevented any of the estates from reaching the point of cash depletion before the conveyance on April 1, 1976.

While it may seem conceptually difficult to characterize a government grant as giving rise to a claim for just compensation on a taking, the point is more troubling than might appear at first blush since the advances did prevent abandonments that otherwise could lawfully have occurred. The Government parties themselves recognize that the argument cannot be pressed to the extreme that erosion claims could be forever avoided by spooning out enough cash to enable a carrier to pay the most necessitous items such as bills for wages, supplies, interline balances, and installments on equipment obligations, while letting other priority items, notably state and local property taxes, continue to accrue. Their position is limited to what they and we consider the situation here, where generally speaking the conveyance occurred within a reasonable time after the beginning of serious discussion of the Rail Act, as measured by the time that would have properly been consumed if applications for abandonment or sale had then been filed. Under such circumstances we do not think the trustees can insist that they had a constitutional right to avoid government cash advances necessary to keep the railroads alive for such a reasonable time as was necessary to effect a solution that would maintain the essential rail services which the Northeastern railroads had conducted long and, until recent years, profitably. It was not until the winter of 1973 that any of the trustees or reorganization judges sounded the clear notes of warning that led to enactment of the Rail Act; we perceive no taking in Congress' having found means to keep the railroads running for a reasonable period while a solution was being devised, submitted to Congress, and consummated.[43] As previously indicated, we will allow a transferor to attempt to show that, but for the Rail Act and the discussions leading up to it, it should have been able to conclude proceedings for abandonment or sale, and to discontinue operations, prior to April 1, 1976; providing a railroad with sufficient

cash to see it through such a period is not an unconstitutional taking.

While we attach no importance to the fact that §§ 213 and 215 funds were advanced only on application by the trustees, we cannot accept the now prevalent characterization of the Rail Act by the bankrupt estates as something forced by Congress on unwilling victims. In pleading at the 1973 House hearings for government action that would resolve the conflict between the interests of the public and the owners, Jervis Langdon, Jr., a PC Trustee with long railroad experience, noted that "in the absence of such a resolution, we must go down the uncertain path of liquidating an enterprise of unprecedented size and importance."[44] to be sure, Mr. Langdon was advocating a solution in which erosion would be stemmed from the date of enactment of the new statute. But we believe that if a referendum had been taken among the security holders, a large majority would have preferred the solution afforded by the Rail Act—especially as that was improved by the RRRRA in 1976 through the provision of certificates of value carrying the full faith and credit of the United States for any shortfall between the value of ConRail securities and the net liquidation value (taking account of CUE and VOB) of the properties conveyed—to the "uncertain path" of liquidation.[45] We find it unlikely that any responsible railroad interests wanted, or expected, liquidation; such opposition as there was to the Rail Act was founded rather on the hope that, faced with a cessation of operations, particularly by the PC, Congress would do something even better for the railroads. We decline to rule that the Fifth Amendment requires such an essay in brinksmanship.[46]

In sum, subject to the caveat noted above concerning supported showings of "pre-conveyance date" abandonment or sale in a non-Rail Act world, and the reservation with respect to administrative claims noted in the next section of this opinion, we are thus of the view that PC suffered no pre-conveyance CUE.[47]

Appendix C

V. The Cases Other Than Penn Central

In this section of the opinion we shall deal with arguments of the smaller roads, most of which contend that their claims for pre-conveyance CUE are even stronger than Penn Central's.[48]

Before going into specifics, we note that the Government parties, which generally denying the existence of pre-conveyance CUE, have suggested that we might leave two points open for later decision. One, to which we have already referred, is that a railroad might be entitled to pre-conveyance CUE if it could show that but for the Rail Act (a concept we would enlarge to include the effect of the discussions that began in February 1973 leading to its passage), it would have filed for abandonment[49] and should have been able, with the exercise of reasonable diligence by the Government authorities, to procure a decision thereon and carry out the abandonment before April 1, 1976. The other is that pre-conveyance CUE might exist if it should develop, in the language of counsel for the Government parties (Transcript of argument, 124) "that a person who extended credit to the railroad during the time it was subject to the administration of a Reorganization Court may have relied upon the authority of the Court as guaranteeing that its administration claim would be paid in full,"[50] and should ultimately find such reliance to have been unjustified. For reasons indicated in Section IV, we consider the first reservation (also expanded to include sales) to be a necessary one; we shall also leave the second point open as the Government parties suggest, since we may never need to decide it if the ultimate valuation is sufficient to cover such claims.

A. *Central Railroad Company of New Jersey (CNJ)*

Of the debtors involved in these proceedings, only the CNJ had initiated reorganization proceedings before PC, to wit, on March 22, 1967. CNJ was atypical in several respects. It carried a burden of commuter passenger traffic in the northern New Jersey metropolitan area which was huge in comparison with its total

operations; its freight services were almost entirely those of a terminating or originating carrier; and we are told that its divisions with longer-haul carriers moving the traffic from and to the west were unfavorable—particularly the divisions in the Wilkes-Barre—Scranton, Pa., area. As early as November 27, 1970, Manufacturers Hanover Trust Co., Indenture Trustee of CNJ's General Mortgage Bonds, filed a petition requiring parties in interest to show cause why the reorganization proceeding should not be dismissed; the court referred this to the ICC for recommendation as required by § 77(g) of the Bankruptcy Act. No action was ever taken by the Commission but the Indenture Trustee took no proceedings to compel this.

For reasons unnecessary to detail, the Trustee initially appointed for the CNJ resigned; the present Trustee, Mr. Timpany, took office in January 1971. He developed a plan outlined in a letter dated March 6, 1971 to the Administrator of the Federal Railroad Administration, which came to be known as a Blueprint for Survival. This included transformation of the CNJ largely into an originating and terminating road serving the northern New Jersey metropolitan area, elimination of its Pennsylvania operations through transfers to other roads which they largely paralleled, sales or abandonments of other portions of the line, discontinuance of a portion of the lighterage service in New York Harbor, revision of CNJ's passenger service contract with the State of New Jersey so that this would cover all costs rather than merely avoidable costs, and sale of a bridge over Newark Bay to The Port of New York Authority which would reimburse CNJ for additional expense in routing traffic over the lines of other carriers. The letter concluded on an optimistic note and constituted the basis for an application for $10 million in federally guaranteed loans under the Emergency Rail Services Act of 1970.

On March 24, 1971, the Secretary of Transportation issued his findings on the Trustee's application which he determined to grant in the amount of $6 million. As required by § 3(a) of the

1970 Act, the Secretary found that cessation of essential transportation services by the CNJ would endanger the public welfare; that cessation of such services was imminent; that issuance of federally guaranteed trustee certificates was the only practicable means of obtaining funds to meet payroll and other expenses needed to provide such services; that the CNJ "can reasonably be expected to become self-sustaining"; and that the probable value of its assets in the event of liquidation afforded reasonable protection to the United States.

The Trustee's application to the reorganization court for authority to issue the certificates was opposed by bondholders. The reorganization judge, Judge Augelli, granted the petition on March 22, 1971, finding that "with the help of the new money, a successful reorganization is indeed feasible and that such reorganization will be effected within a reasonable time." The bondholders did not appeal.

The substantial complaints of the CNJ Trustee begin at this point. There were delays in obtaining authority for abandonments; indeed the Trustee abandoned the Pennsylvania operations without administrative authorization pursuant to an order of the reorganization court permitting temporary suspension of operations pending ICC decision and cessation of operations if the ICC denied the application[51]—action sustained by a panel of the Third Circuit, 455 F.2d 989 (1972), in a per curiam decision which seems basically inconsistent with the later en banc decision, 485 F.2d 208 (1973), *cert. denied,* 414 U.S. 1131 (1974), refusing to allow abandonment of New Jersey passenger operations without application to the appropriate federal and state commissions.[52] The Commission did not fully grant other applications contemplated by the Blueprint, *see R.D. Timpany, Trustee of the Central Railroad Co. of New Jersey—Abandonment of Operation Between Phillipsburg, N.J. and Hudson, Pa.,* 342 I.C.C. 227 (1972); *Routing via Oak Island Jct., New Jersey,* 341 I.C.C. 129 (1972), some of which were opposed by other roads,[53] but the Trustee did not seek judicial review.[54] The ICC failed to act on

applications filed on July 13, 1972, F.D. No. 27145, and December 13, 1972, F.D. No. 27265, for authority to use the Penn Central's Newark Bay Bridge and to provide for major consolidation in the northern New Jersey metropolitan area; the Commission also suspended tariffs providing for a surcharge designed to increase freight revenues by 20%, I & S Docket No. 8932, and declared agreements with shippers to increase revenues to be illegal, *Contract Service Charges Between New Jersey Points,* I & S Docket No. 8702. The State of New Jersey did not enter into the full cost of service passenger contract for which the Trustee had hoped.

Meanwhile, in May 1972 the Indenture Trustee had moved for an order directing the termination of all CNJ's operations on the ground that continued operations had become unconstitutional. The Reorganization Trustee and a Bondholders' Protective Committee opposed this, pointing to various favorable developments. On December 8, the court refused to take this "drastic step" on what it considered an insufficient record, indicating that it did not think "the constitutional line" as to erosion had then been passed. There was no appeal. Shortly thereafter the court did direct cessation of New Jersey passenger service effective January 21, 1973 in the absence of a new contract with the State, saying that without a full compensation agreement "we will run into an erosion of assets that will result in an unconstitutional taking of the debtor's property." This was the order which, after affirmance by a a panel, was reversed in August 1973 by the Third Circuit in the *en banc* opinion to which we have often referred, 485 F.2d 208.

The Trustee contends that the beginning of Congressional discussion of the Rail Act in early 1973 brought to a halt many promising developments[55] including negotiations for a revised passenger contract with the State of New Jersey which had progressed while operations continued under an interim revised subsidy contract.[56] The Trustee advances as further evidence of the adverse effect of the Rail Act that after Judge Augelli had

ruled that the CNJ could not be reorganized under the Rail Act, the State negotiated a greatly improved subsidy contract, from which it turned back after our reversal of the reorganization court's ruling. Finally the Trustee refers to various proceedings during the early part of 1976 before the reorganization court (now Chief Judge Whipple) with respect to the payment of interline balances and other current claims. These culminated in an opinion and order dated March 31, 1976, which directed payment of interline and certain other priority claims but deferred payment of other pre-conveyance administration expenses until the post-conveyance situation could be assessed. We think it best to defer consideration of this last group of contentions until we have a clearer statement of just what the Trustee claims and what the Government parties respond; it may be that all this is a matter for the reorganization court and the Third Circuit rather than for us.

We do not see how any of this entitles the CNJ to more favorable treatment on the issue of when the period for government action should have begun than what we have recognized to be proper in the case of PC. The CNJ's having entered reorganization more than three years before PC is inconsequential; as late as March 22, 1971, the reorganization court found that the CNJ was reorganizable on an income basis if the Trustee's program was carried out and the creditors took no appeal. While the Indenture Trustee sought to have operations cease in December 1972, the reorganization court found that the Indenture Trustee had failed to show that such cessation was constitutionally required, and no appeal was pursued. The Trustee has made a rather impressive showing that Congress' consideration and enactment of the Rail Act had a particularly negative effect on the CNJ; but we give full weight to that by allowing him to prove, if he can, that but for discussion of the Rail Act he would have initiated proceedings for abandonment or sale in February 1973 and that these should have been concluded and the transaction consummated before April 1, 1976. The other reservation proposed by the Government parties will answer fears expressed by

the Trustee that if we should adopt the valuation theory of the Government parties, which he challenges, the estate may not be able to pay administration expenses.

B. *Reading Company*

A principal basis on which the Trustees of the Reading contend that it has a special entitlement to pre-conveyance CUE is that it was doomed by the Penn Central merger, as a result of which it lost revenues on traffic previously interchanged with the New York Central at Newberry Junction, Pa. and other points. The course taken by the Reading, long a "family line" of the Baltimore & Ohio, in not obtaining inclusion in the B&O-Chessie System at the time of that merger, opposing the Penn Central merger, or, until belatedly, even seeking special protective conditions, has been the subject of previous judicial comment. *See Erie-Lackawanna Railroad* v. *United States,* 279 F. Supp. 316, 330-32 (S.D.N.Y. 1967), *modified and aff'd, Penn Central and N & W Inclusion Cases,* 389 U.S. 486, 519-20 (1968). Despite the losses from the PC merger the Reading did not enter reorganization until November 23, 1971.

In May and June, 1973, the Institutional Investors Reading Group filed a petition and amended petition. The latter asked the court to fix October 5, 1973 as the date by which the Trustees should file either a plan of reorganization for continued rail service or a plan of liquidation,[57] and Januay 4, 1974 as the date on which all rail operation would cease unless a plan of reorganization had been filed before October 5 and the court should have determined before November 2 that reorganization pursuant to the plan was feasible. The Reorganization Trustees opposed this, pointing to such things as prospects for increased "piggyback" and coal carriage on account of the energy crisis, various cost reduction and revenue improvement efforts, as well as the possibility of federal legislative response to the Northeast rail situation. An affidavit of J. R. Greene, Vice President-Finance,

prophesied that available cash would double from $2.6 million on July 31 to $5.0 million on December 31, 1973. He pointed to other favorable prospects, including a shift of freight traffic from the Penn Central line serving the Washington-New York-Boston passenger "corridor" to alternate routes of the B&O and the Reading. He also referred to the legislative proposals then pending before Congress and to the benefits the Reading would derive from them. Hearings were held on August 1 and 2. Alfred W. Hesse, Jr., Vice President-Law, testified to the difficulty in formulating a plan in light of the legislative uncertainties, stating that in his opinion the Reading would be included in the proposed restructuring of the Northeast roads. He added that each of the bills arguably provided for protection of the estates during the period in which cessation of operations was to be forbidden. He thought that in the absence of legislation "about October 1" would be the date when the Trustees would "begin the works" of seeking a cessation of service. Although a recent affidavit of Mr. Hesse states that this would have led to cessation of operations on December 1, 1973, the affidavit does not explain how this could lawfully have been accomplished. Apparently the court took no action on the investors' petition.

In contending that CUE began to accrue on December 1, 1973, if not before, the Reading Trustees, like the PC Trustees and the CNJ Trustee, simply ignore the provisions of § 77(g) that the reorganization judge must obtain a recommendation for the ICC before dismissing a proceeding and of § 1(18) of the Interstate Commerce Act requiring the Commission's approval of abandonment.[58] The utmost the Reading Trustees can derive from the record here presented is that, absent discussion of the Rail Act, it would have become the duty of the reorganization court late in 1973 to direct that steps be taken that would permit a lawful cessation of operations.[59] As against this, in the presentation before Judge Ditter in the proceedings under § 207(b) of the Rail Act, the Reading Trustees forecast negative net railway operating income of only $1.55 million for 1974 and positive net railway

operating income of $3.6 million for 1975. *In the Matter of Reading Company*, 378 F. Supp. 474, 476 (E.D. Pa. 1974). While the judge regarded these figures as "overly optimistic," *id.* at 479, his main reason for finding that the Reading was not reorganizable on an income basis was the competition it would face from ConRail and the disappearance of the projected Mid-Atlantic Railroad Company (MARC) as a realistic probability in light of the Rail Act.[60]

The Reading's case for pre-conveyance CUE is thus weaker than PC's or CNJ's. We see no reason to give it the benefit of the assumption that but for the discussion of the Rail Act, it would have filed for abandonment in February, 1973; the earliest date supported by the record for such a hypothetical filing is October 1973. We leave it open to the Reading Trustees to prove, if they think they can, that a petition for abandonment or sale filed in late 1973 should have been acted upon and the transaction consummated before April 1, 1976.

C. *The Lehigh Valley*

The case of the Lehigh Valley (LV) Trustee is much more appealing. As early as July 24, 1972, the Trustees filed a "General Plan for Reorganization" in which they concluded that reorganization of the LV as then configured on an income basis was impossible and that successful reorganization depended on a consolidation of its facilities with those of the Reading and the CNJ. However, it became apparent as a result of cash shortages that this plan could not be carried out, and on March 13, 1973, the Trustees filed a petition with the reorganization court (Judge Fullam) for leave to cease operations on October 1, 1973 unless the court should find prior to September 1 that an income based reorganization was "probably feasible and can be consummated within a reasonable period of time consistent with the creditors constitutional rights." Like other petitions to which we have referred, this one seems to have assumed that § 1(18) of the

Interstate Commerce Act had no application. A hearing was held in June 1973. Judge Fullam deferred ruling "[i]n view of the imminent prospect of legislation. . . ." *In re Lehigh Valley Railroad*, 382 F. Supp. 842, 844 (E.D. Pa. 1974) (opinion under § 207(b) of the Rail Act).

The LV Trustee is entitled to endeavor to establish that but for the discussion of the Rail Act he should and would have filed for abandonment or sale early in 1973, and to prove that such an application should have been acted upon and the transaction consummated before April 1, 1976.[61]

D. *The Lehigh & Hudson River Railroad*

The Lehigh & Hudson River Railroad (L&HR) is a small bridge carrier[62] operating between points in Pennsylvania where it connected with the PC and LV and Maybrook, N.Y., where it connected with the New Haven. After inclusion of the New Haven in the PC system, the PC diverted much New England traffic formerly handled over the L&HR to its route on the west bank of the Hudson River to Albany and thence over the former New York Central line into New England. Because of this loss of traffic the L&HR filed for reorganization in the Southern District of New York in April 1972.

After having borrowed $200,000 secured by a chattel mortgage on four locomotives,[63] the Trustee, on July 9, 1973, filed a petition with the reorganization court (Judge Ward) for an order directing cessation of operations no later than October 1, 1973, unless a finding should be made by the court prior to September 1, 1973, that "an income based plan of reorganization is probably feasible and can be consummated within a reasonable period of time consistent with the creditors' constitutional rights." The petition indicated doubt as to the Trustee's being able to meet payrolls after October 1. Hearings were held on July 26 and 27. Counsel for the United States neither supported nor opposed the petition; he thought "temporary" cessation of operations might

not require ICC approval and asked only that the track be left in place. The court took no action in light of the probable enactment of the Rail Act.

The L&HR Trustee has made out a case for taking July 31, 1973 as the date by which an application for abandonment or sale would have been made but for the pendency of the Rail Act. Also, in view of the small size of this carrier and the predominately bridge character of its traffic, he may have a better chance than most to show that a reasonable time for action by the ICC would have expired and the transaction would have been consummated before April 1, 1976.

E. *The Ann Arbor Railroad Company*

The Ann Arbor Railroad, a subsidiary of the Detroit, Toledo & Ironton Railroad Company (DT&I), extends in a northwesterly direction from Toledo, Ohio, through Michigan, to Lake Michigan, across which it operated car ferries to terminals on the Wisconsin side of the lake. Two of these car ferry routes had been abandoned, with ICC approval, in 1968, and 1970. On June 19, 1972, the Ann Arbor filed a petition, FD-AB49, for authority to abandon the two remaining car ferry routes, between Frankfort, Michigan, and Manitowoc, Wisconsin, and between Frankfort, Michigan, and Kewaunee, Wisconsin, together with a connection 20.53 mile line of railroad between Thompsonville and Elberta, Michigan, plus a 1.87 mile spur from Elberta to Frankfort. The car ferry operations allegedly caused losses of more than $877,000 in 1970, $1,075,000 in 1971, and $1,330,000 in 1972, based on the ICC's "50-percent" rule used to estimate off-branch costs in ICC abandonment proceedings — a formula alleged to have the result of understating losses under the circumstances here presented. The ICC took no action on the petition because of the "freeze" it had imposed on abandonment applications after the district court decision in *Harlem Valley Transportation Association* v. *Stafford*, 360 F. Supp. 1057 (S.D.N.Y.,

June 21, 1973), that the ICC staff must prepare an EIS where abandonment applications constituted "major Federal actions significantly affecting the quality of the human environment," *see* 42 U.S.C. § 4332(2)(C), during the course of an appeal to the Second Circuit, which affirmed on June 18, 1974, 500 F.2d 328.

By the time the freeze was lifted, *see* 384 F. Supp. at 921-22, Congress had enacted the Rail Act which transferred to USRA authority to permit abandonments of carriers being reorganized under the Rail Act but forbade the granting of permission to abandon if this was reasonably opposed by any affected State or local or regional transportation authority, § 304(f) [now § 304(h)]; both Michigan and Wisconsin opposed abandonment of the two car ferries. Meanwhile the Ann Arbor had filed on October 15, 1973 for reorganization under § 77 in the Eastern District of Michigan. We are told that although it had been hoped that if the Ann Arbor were shorn of its car ferry operation, it might show a profit, these hopes faded as 1973 progressed, and the reorganization court (Judge Pratt) found on July 1, 1974 with the assent of all parties that the Ann Arbor was not reorganizable on an income basis and should be reorganized under the Rail Act.

The Ann Arbor may well be entitled to pre-conveyance CUE with respect to erosion from operating the car ferries and the related mileage sought to be abandoned. The application, which made a strong showing of an unconstitutional deprivation, had been on file for a year and a half when the Rail Act was enacted; apparently the Ann Arbor was a victim of the ICC's action in unilaterally declaring a moratorium on the disposition of abandonment applications while the *Harlem River* litigation was in progress, or of the consideration of the Rail Act, or of both. The rest of the line stands differently. Here there is nothing to indicate that but for discussion of the Rail Act the Trustee would have sought abandonment as early as February 1973; apparently this might have been done sometime in the spring of 1974.

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F. *Erie Lackawanna Railway Company*

The Erie Lackawanna Railway (EL) filed for reorganization under § 77 in the Northern District of Ohio on June 26, 1972. However, in proceedings during the spring of 1974, the reorganization court (Judge Krupansky) found in its Order No. 234 that EL was reorganizable on an income basis. Subsequent developments are recorded in our opinion of April 11, 1975, as follows, 404 F. Supp. 954, 955-56:

> As a result of adverse economic developments unforeseen when the order (Order No. 234) was entered, EL failed to realize the results projected for 1974. On January 9, 1975, the EL Trustees announced their changed conclusion that EL was not reorganizable on an income basis under § 77 within a reasonable time and their intention to seek an amendment of RRRA that would permit EL to be brought under that Act, as it might initially have been. Less than a month later a number of EL's Indenture Trustees filed a petition in the district court for an order dismissing the § 77 proceeding in favor of an immediate equity receivership and fixing a date for cessation of operations. About the same time the EL Trustees filed a petition for authority to cease operations because of prospective lack of sufficient cash to meet payrolls and other bills; this petition was later withdrawn in light of the prospect of enactment of the amendatory legislation that would enable EL to be placed under RRRA, which the EL Trustees were seeking. The Trustees announced that if the amendment was adopted they would petition for reconsideration of Order No. 234; the Indenture Trustees sought unsuccessfully to enjoin this. On February 27, 1975, the district court began a hearing to consider the various matters that had been brought to its attention.

The amendment became law on the following day, 89 Stat. 7 (1975). The Trustees, on March 3, 1975, filed a petition asking the reorganization court to reconsider Order No. 234 and determine that reorganization should proceed under the Rail Act; they also petitioned for authority to enter into arrangements for emergency financial assistance under § 213. The court granted both petitions, and we affirmed its decision on the former. The EL Trustees sought and received emergency assistance under §§ 213 and 215.[64]

Although the EL Trustees make more extreme claims, the main thrust of their position is and has to be that CUE began to accrue in January 1975 when they became aware of the seriously adverse change in their prospects of successful reorganization and the prospective exhaustion of cash. What we have said in regard to the case of the PC Trustees applies with still greater force to the EL Trustees. EL's decision to bring itself under the Rail Act simply started the clock running, and the conveyance date came less than 15 months after the EL Trustees made their plight known and secured the amendment of the Rail Act needed to allow EL to come under it.[65] We have already given our answer to the argument that but for the Rail Act the EL Trustees would have been freed from any requirement of securing § 1(18) approval by sheer impossibility; we do not think any CUE rights accrue if Congress provides the wherewithal to keep even such a railroad alive for what would have been no more than a reasonable period for the ICC's acting upon an abandonment application. In sum, unless the EL Trustees can show there were substantial pieces of their line for which but for the Rail Act petitions for abandonment or sale would have been filed in March 1975 and should have been acted upon so as to permit consummation before April 1, 1976, a showing we would think almost hopeless, they are not entitled to pre-conveyance CUE.

VI. Conclusion

We should not end this opinion without reference to a basic theme running through the briefs of almost all the trustees and investor interests which we have not discussed in express terms. This is that after a certain date, claimed (except in the case of the EL) to be certainly no later than January 2, 1974 and generally before, the bankrupt railroads were operated solely in the public interest and the Constitution, as construed in *Brooks-Scanlon* and other cases, requires the public to pay for losses incurred during that period.

Our discussion in Section IV was mainly directed to showing that even if the premise were sound, the conclusion would not follow since the Constitution does not require that a losing railroad be permitted to quit immediately even if its continued operations during administrative proceedings conducted with reasonable diligence served no private ends. We think also that the premise is highly questionable. With deep respect for the sincerity of counsel, we believe their concentration on maximizing claims for pre-conveyance CUE has produced a certain amount of myopia as to the parlous condition of these railroads in 1973. As we said in our opinion on the 180-Day Appeals, 384 F. Supp. at 917:

> [T]here is a certain incongruity between the high demands which the investors make of the Act and the unhappy position they, or in any event most of them, occupied when it was enacted. The idea that billions of dollars of liquidation proceeds of these bankrupt railroads are lurking just around the corner is unrealistic in the last degree.

The prospect of having to liquidate these bankrupt estates in a region largely deprived of railroad service was scarcely enticing. The various trustees answer that this would not have happened, that if the respective reorganization courts had issued orders

permitting a shutdown when cash available for operations had sunk to the level described in fn. 31 of our opinion on the 180-Day Appeals, 384 F. Supp. at 919, as they could lawfully have done, Congress would have stepped in with something—either outright condemnation or, alternatively, an interim take-over of the use of the roads with the Government shouldering all losses until a solution like the FSP could be devised and consummated. These, of course, are possibilities,[66] but no one in the dark days of 1973 could have been sure that either would materialize or what form they would take if they did. The Rail Act itself and the committee reports accompanying the House and Senate bills[67] afford evidence that Congress was not prepared to go so far so fast. The more likely response to imminent cessation because of cashlessness would been the provision of further emergency assistance. Moreover, the possibility or even a probability that the federal government, had it been faced with an imminent shut-down, might have come up with something more favorable to the railroads than the Rail Act in erosion terms does not mean that erosion borne by the roads under the chosen solution constitutes a "taking"; the mere fact that the government chooses one alternative over another does not make it liable for the greater benefits the railroads would have realized from a choice it rejected or never had to consider.

As previously indicated, we are confident that, *non constat* the position of various indenture trustees who had to be conscious of their fiduciary responsibilities, if a referendum had been taken a vast majority of the security holders would have favored continuing operations through 1973 in the hope of passage of the Rail Act or something like it and thereafter for a reasonable time for formulating and consummating the FSP. In our view therefore, operations were continued up to and beyond the point of the railroads' own "cashlessness" not solely to serve the public interest, nor solely to serve the private interest of the estates, but to serve both.

These and other considerations we have canvassed might seem to lead to a complete refusal to recognize pre-conveyance CUE. Yet even the Government parties do not urge us to go quite that far. At argument, although not explicitly in brief, they were willing to leave open for further consideration the case of the small railroad that might have been able to secure abandonment authority and to have discontinued operation but for the Rail Act before April 1, 1976, and the case where administration claims exceed the value of the bankrupt estates. We have gone somewhat beyond the former concession and have held that CUE would begin to accrue on a date when the Interstate Commerce Commission should have granted an application for abandonment or sale which would have been filed if the Rail Act and the debate over its passage had not rendered this futile and operation had been discontinued as a result.[68] We realize that this solution will not be truly satisfactory to anyone, especially to the various trustees and the estates they represent, although both they and the Government parties should take account of our correlative holding that, to the extent that the Government has used its "reasonable time to secure abandonment or sale permission" argument to postpone the accrual of CUE, it cannot use the same period a second time to reduce the value of the properties conveyed on April 1, 1976 in any discounting required to reflect the need of securing regulatory approval for dispositions in a non-Rail Act world.

Parties on both sides have noted that in contrast to the almost total disagreement on when CUE commenced to accrue, there is a considerable measure of agreement with respect to the elements entitled to recognition as its components. Now that we have prescribed guidelines with respect to the accrual of CUE, we do not think it unreasonable to ask the parties to endeavor, in the same spirit of cooperation they have manifested on many matters, to flesh these out by agreement among themselves in terms of precise properties and dates.[69] One thing that has been obvious about these proceedings from the beginning is that no amount of

effort by counsel and the court will produce a mathematically precise figure of what the estates are constitutionally entitled to receive and the Government is required to pay; the best for which anyone can hope is a fair approximation. We realize that the amounts here at stake are large; that the Government parties may be fearful that any agreement, even on the limited points here suggested, would be criticized by members of Congress or the media as too favorable to the railroads; and that the trustees may be equally fearful of claims that they have not fully discharged their fiduciary responsibilities. But it has now become apparent that agreement on some points will be vital if this court is to meet what we once thought to be the unduly pessimistic five to ten year timetable forecast by Representative (now Secretary of Transportation) Brock Adams, *see* 119 Cong. Rec. 36355 (Nov. 8, 1973); 384 F. Supp. at 926. If this court can assist by elaboration of this opinion or otherwise, it stands ready to do so.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

April 19, 1977

Appendix C

FOOTNOTES

1. As noted in our opinion of October 18, 1976, 425 F.Supp. 266, 269-70, we shall treat the "fair and equitable" language of § 303(c) as equivalent to the standard of "constitutional minimum", unless in the valuation proceedings there should be a specific and supported claim that the standards differ in result.

2. *See also* the last sentence of § 303(c)(3).

3. *See also* Senate Conference Report No. 595, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., Jan. 28, 1976):

> The base value of the certificates is to be increased by whatever amount, if any, of compensable unconstitutional erosion the special court finds to have occurred in the estate of the railroad transferor of rail properties holding the particular series of certificates during the period of the bankruptcy proceeding of such estate.

4. In our 1974 opinion, we concluded that we could direct compensation for unconstitutional erosion in any of the properties owned by the estate of a railroad under the Act, whether or not the properties were conveyed, so long as the railroad was the transferor of some properties; we noted, however, that our ability to assure full compensation was limited, especially if the transferors' principal valuation claims should be sustained, 384 F. Supp. at 925-26 & n.51, leaving suit in the Court of Claims under the Tucker Act as the only alternative for any transferor whose claims were thus not satisfied. The current Act makes explicit our ability and obligation to take into account compensable unconstitutional erosion in determining the base value of the certificates of value which are issued to every railroad that has transferred some properties to ConRail. The unrestricted language of § 306(c)(4) and the interest expressed by the 1976 Conference Committees of the House and Senate in promoting judicial economy, *see infra*, indicates we should include in the base value of the CV's all compensable unconstitutional erosion suffered by a transferor to ConRail, whether in the properties transferred to ConRail or to a profitable railroad or in properties not transferred at all. However, as the PC Trustees note, any post-conveyance erosion damages which accrue after this court's final decision on valuation still would have to be left to the Court of Claims for remedy.

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The House and Senate Conference Committees commented on the erosion provisions as follows:

> For reasons of judicial economy, if for no other reasons, it is desirable that the court that is rapidly acquiring vast knowledge of the regional rail reorganization problem take into account the so-called erosion claims in its section 303(c) determinations. There is no intention even remotely to imply that there may be merit in a claim for pre-Act erosion, or indeed for any erosion. However, we are interested in simplifying the litigation, and take note of the fact that there is now pending in the Court of Claims an action alleging both pre-Act and post-Act erosion. In line with the same goal, it is our intention that all actions for unconstitutional erosion now pending or subsequently filed in the Court of Claims be stayed until the Special Court has ordered the distribution of the securities and the certificates of value pursuant to section 303(c)(4) of this Act.

S. Rep. No. 520, 94th Cong., 2d Sess. 205 (1976), *as corrected* 122 Cong. Rec. S749 (daily ed., Jan. 28, 1976) (clerical corrections).

5. We added that "a relatively early resolution of these issues [was] essential in order to enable us to direct what studies should be prepared, since USRA contends that there has been no CUE."

6. At oral argument counsel for the Penn Central (PC) Trustees indicated a belief that we had not set for discussion the issue whether valid erosion claims began on January 2, 1974, the date of enactment of the Rail Act, or any date subsequent to that date and prior to April 1, 1976. We see no basis for such a reading of the June 16 Memorandum, *see* fn. 5. While we singled out claims for erosion prior to January 2, 1974 and subsequent to March 31, 1976, as creating special problems, the memorandum made clear that we wished to deal comprehensively with all relevant legal issues pertaining to CUE. No different conclusion was justified by so much of our opinion of October 18, 1976, 425 F. Supp. at 270-71 as deferred decision whether the Rail Act was a reorganization statute or a condemnation statute or both. In any event the briefs and arguments include all material relevent to our making a determination whether CUE begins to accrue on January 2, 1974, or at some date between then and March 31, 1976, if it had not previously begun to accrue, and the brief of the PC Trustees itself argues, p. 113 n.1:

> If, contrary to our contentions, it should be determined that Penn Central did not reach the point of erosion taking prior to the passage of the Rail Act, then it would be our contention that passage of the Act itself accomplished such a taking by subjecting Penn Central to a further period of compelled operations beyond the point of unreorganizability.

Also we have had the benefit of reading the full presentation in the brief of the PC Trustees filed January 6, 1977, to the effect that CUE began to accrue on January 2, 1974, if it had not done so before.

7. *See Pennsylvania* v. *ICC*, 535 F.2d 91, 97-98 & n.13 (D.C. cir. 1976), *cert. denied*, 45 U.S.L.W. 3251 (U.S. October 4, 1976), suggesting that this was a matter for the Court of Claims.

8. In addition, we do not pass at this time on the claim, advanced only by the Erie Lackawanna (EL) Trustees, for any income tax liability that may, despite P.L. 94-253 (March 31, 1976), 90 Stat. 295, accrue on an award for CUE.

9. There is general recognition by the parties that determination of the amount of some elements of physical erosion, notably deterioration of plant that has been conveyed, will depend on the theory of valuation. Such deterioration would be of much greater importance if a property were to be valued on the bases of sale for continued rail use than if it were to be valued on the basis of a sale for scrap. Because of these and other considerations, this opinion will not discuss the elements of erosion but will be devoted solely to the issue of the date when erosion claims accrued.

10. The railroads in *Brooks-Scanlon* and *Eastern-Texas* had engaged in interstate commerce, but the *Brooks-Scanlon* case was decided before the Transportation Act of 1920 adding § 1(18) was passed, and the Interstate Commerce Commission had authorized abandonment of interstate operation by the Eastern Texas, *see Texas* v. *Eastern Texas R.R.*, 258 U.S. 204 (1922).

11. One of them, the Eastern Texas Railroad, was wholly without cash or credit and could not operate at all. *See* 264 U.S. at 83. The same may have been true of the railroad in the *Bullock* case, *see* 254 U.S. at 519.

12. Although some transferors quote Justice Holmes' earlier statement, 251 U.S. at 399:

> A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage.

It is clear that the portion of the sentence preceding the comma is not the law. *See Fort Smith Light & Traction Co.* v. *Bourland*, 267 U.S. 330 (1925) (Mr. Justice Brandeis writing for a unanimous Court). *Cf. Baltimore & Ohio R.R.* v. *United States*, 345 U.S. 146 (1953).

13. Efforts in the earlier New Haven and Central of New Jersey reorganization proceedings, which might have served as precedent, had been largely aimed at having state or local government bodies assume the burden of commuter passenger service and grant tax relief. The federal government undertook the provision of intercity passenger operations by the National Railroad Passenger Service Act of 1970, 84 Stat. 1327 (1970). There has been a continuing controversy between the PC Trustees and the National Railroad Passenger Corporation (Amtrak) concerning the adequacy of payments by the latter.

Certain of the changes proposed by Penn Central in February 1971 were beyond the complete control of either the federal or state and local governments. For instance, the PC Trustees complained of the "merger guarantee payments" received by PC employees, conditions to which the Pennsylvania and New York Central Railroads had themselves agreed to effect the merger under conditions of labor peace. Similarly, the PC's proposal for a joint labor-management committee to review work rules was addressed to the transportation unions, not the government.

Other changes would have required governmental action, for instance the proposal that "below cost" freight rates be prohibited by legislation, or that the ICC separate rate increases for line haul services and terminal services, but the report does not detail whether the PC had actually proposed draft legislation for the former, or had made application to the ICC for the latter. The PC's proposal for "rationalizing" freight plant—apparently that any losing branch of a railroad should be required to stay in operation, even during abandonment proceedings, only if the branch operating losses were compensated—might be faulted in the case of a profitable railroad for ignoring the constitutional logic of *Fort Smith Light & Traction Company* v. *Bourland, supra*, 267 U.S. 330; again, there is no indication that the PC Trustees had actually put forward draft legislation for such subsidization.

14. The September 1971 report noted that the Trustees' own studies to determine which lines should be abandoned would take at least three

years to complete, although earlier conclusions could be drawn as to 1900 miles of possible abandonments and 5200 miles of track which clearly would be retained; in addition the reorganization court had already approved the preliminary filing of abandonment applications for 1928.4 miles of track with the ICC.

15. The report noted some progress in the PC's efforts to rationalize its operations, including an agreement with the transportation unions implementing work rule changes, and the repeal of New York's and substantial modification of Indiana's full-crew law.

16. It was estimated, for example, that whereas in 1973 the existing railroad would have a deficit of $157.2 million in net railway operating income, an 11,000 mile railroad — if all employees unnecessary to the operation of such a smaller road (except for excess trainmen on crews to be retained) were let go without cost — would have had net railway operating income of $59.0 million.

17. One reason was that "labor would expect large labor protection payments, amounting to $774.1 million through 1976 alone, if Penn Central were free promptly to move to a railroad of 11,000 miles."

18. On the same date the ICC submitted a report, Ex parte No. 293 (1973).

19. ICC approval was to be obtained through the submission of Transfer Reports. The Plan provided that

> The Commission shall promptly hold hearings on the Transfer Reports to determine whether acceptance of the offers recommended by the Trustees or the approval of any offer recommended for rejection by the Trustees would be consistent with the standards of Section 1(18) of the Interstate Commerce Act, Section 77 of the Bankruptcy Act, and of due process. The Commission's decisions shall be submitted to the Court for approval either on an individual offer basis or in the aggregate.

Nothing was said about § 5(2) of the Interstate Commerce Act.

20. The court noted, however, that

> It should be emphasized at the outset that the Court is not now called upon to adjudicate the merits of any proposed plan of reorganization; indeed, § 77(d) of the Bankruptcy Act makes it clear that this Court lacks power to review any proposed plan

> until it has been considered by the Commission and certified to this Court by the Commission. . . .
>
> * * *
>
> Under the provisions of the Bankruptcy Act, there are, arguably, two approaches to a resolution of the Debtor's precarious financial position. The first of these is by way of a plan of reorganization. Such a plan may or may not ultimately provide for liquidation of all or part of the Debtor's railroad. That issue is not before the Court at this time. . . . The Trustees' proposal merely initiates the proceedings before the Interstate Commerce Commission. The plan which they propose to file expressly provides that, in the event of Congressional action before October 1, their plan would be amended. Thus, the Trustees' plan is sufficiently flexible to cover all possible eventualities.

363 F. Supp. at 1265-66.

21. *See Tennessee Central Ry. Abandonment*, 333 I.C.C. 443 (1968), 334 I.C.C. 235 (1969); *In re Tennessee Ry.*, 304 F. Supp. 789 (M.D. Tenn. 1969). The ICC might rightfully have objected, however, that the PC reorganization plan made no provision for seeking abandonment permission under § 1(18), *see* 347 I.C.C. at 82-85, for the termination of service within 10 weeks if no interim compensation was forthcoming to stem erosion, and for the sale for scrap after 6 months of any of the rail assets for which offers had not been received for continued rail use. Under the existing provisions of the Interstate Commerce Act, there is no indication that such § 1(18) proceedings could have been dispensed with, *see* Bankruptcy Act § 77(*o*); *Tennessee Central Ry. Abandonment*, *supra*, 333 I.C.C. at 444-45.

22. Similar requests were later made by other creditor interests.

23. Subsequently, on May 2, 1974, the PC reorganization court made the finding required under § 207(b) of the Rail Act as to whether the PC was "reorganizable on an income basis within a reasonable time under section 77." *In re Penn Central Transportation Company*, 382 F. Supp. 831 (E.D. Pa. 1974). Though Judge Fullam found that the PC was not so reorganizable, this conclusion was not based on the nature of PC's transportation market as such, but on the PC's cash shortage, its burden of administrative expenses, its need for capital to maintain the quality of freight service, and its presumed inability to reduce the size of

its plant to 15,000 or 11,000 miles with expedition. For such smaller plants, assuming the quality of freight service did not deteriorate, the reorganization court estimated a net railway operating income (before fixed charges) of $39.8 million and $104.9 million, respectively, in 1976, and $102.8 million and $171 million in 1978. *Id.* at 842. Even with its current plant, the court projected that PC would improve its net railway operating income from negative $153.2 million in 1974 to negative $14.0 million in 1978. *Id.* at 840.

24. USRA was authorized to extend the certification date to a date not more than 30 days after March 12, 1976, by notice filed with this court, the Congress, and the reorganization courts not later than February 10, 1976. § 209(c) as amended. USRA did not take advantage of this authorization.

25. In *Brooks-Scanlon* the railroad had ceased operating, initially with permission, but the Louisiana Railroad Commission, after a hearing, had ordered it to resume; Mr. Justice Holmes treated with contempt a suggestion that, despite the full hearing and order by the Commission directing a resumption of operations, the railroad must start a new proceeding with a petition for leave to discontinue which would surely be denied, 251 U.S. at 400. In *Bullock* the railroad had earlier applied to the Florida Railroad Commission for leave to discontinue and had been refused, 254 U.S. at 519. The Eastern Texas had received authority from the Interstate Commerce Commission to abandon its interstate business, *see* fn. 10 *supra*, and the Court found there was no Texas statute requiring it to obtain authority to abandon intrastate operation.

26. In a footnote to the passage quoted above, the court cited *Bankers Trust Company* v. *Gebhart*, 195 F.2d 238 (2 Cir. 1952), in which an indenture trustee of a hopelessly losing railroad sought to prevent a further loss of equity allegedly available for bondholders that would occur through the reorganization trustees' conveying the railroad's equity interest in two locomotives to the RFC in exchange for an extension of maturity on two other classes of equipment trust certificates. The Second Circuit, speaking through Judge Frank, directed the reorganization judge to pass on the indenture trustee's petitions to require the reorganization trustees to apply to the ICC for abandonment before making the conveyance. Again there was no hint that abandonment proceedings could be dispensed with.

27. One of the points in dispute between the New Haven Trustees and Penn Central was the Trustees' demand that a larger portion of the

consideration be paid in stock rather than in debt. *See New Haven Inclusion Cases*, 399 U.S. 392, 483-84 (1970).

28. The Court's reasoning does lead to the conclusion that to the extent the Government parties make use of the delay between enactment of the Rail Act (or any earlier date taken as starting the period for governmental action) and April 1, 1976, to defeat a claim for CUE on the ground that at least that much time would have been consumed in obtaining permission to abandon or sell, that period cannot be taken into account a second time in determining when the proceeds of sales would come into hand. *See* 399 U.S. at 466, quoting with approval Judge Anderson's opinion, 304 F. Supp. at 801.

29. Though the New Haven Trustee opposed the PC's application in early 1971 to issue $100 million in federally guaranteed trustees' certificates under the Emergency Rail Services Act, and disputed the feasibility of the PC Trustees' April 1, 1972 plan of reorganization, *see* text *supra*, he did not move the reorganization court to dismiss the § 77 proceedings until October 9, 1973.

30. Though the Trustees announced in February 1973 that $600-800 million government aid to finance improvements over a period of years was prerequisite to further attempts to effect an income-based reorganization, because of the cash shortages faced by the Penn Central and the urgent need to improve the condition of the railroad plant if freight revenues were to be increased, they also said that with such aid reorganization still seemed feasible. As the Trustees noted on January 1, 1973, "[W]ithout government financial assistance for improvement of the railroad, a reorganization of Penn Central cannot be achieved in 1976 . . . . If this support is forthcoming promptly, the Trustees believe that Penn Central can be successfully reorganized on a private-income basis by 1976," assuming the three other conditions of eliminating unnecessary employees, uneconomic freight lines, and uncompensated passenger service were also attained. On February 1, the Trustees again noted, "The Trustees believe that the plant and equipment investment program described in this Report will result in a viable railroad which can remain in the private sector."

Similarly, as noted in the text, *supra*, Judge Fullam's March 6, 1973 order warning of a possible October dismissal of the reorganization proceeding was expressly left open to reexamination in light of legislative developments, and was apparently based on the increasing size of

PC's erosion burden rather than a conclusion as to PC's ultimate reorganizability. In authorizing the PC Trustees to submit a plan of reorganization to the ICC in July 1973 providing for liquidation of the railroad, the court expressly noted it was not empowered to pass on the merits of the plan until after ICC review, *see* fn. 20 *supra*. In the October 12, 1973 hearing Judge Fullam deferred action on proposals to dismiss the reorganization, pending legislative action.

The PC Trustees argue that at the time of the October 12, 1973 hearing, "the principal legislative draft was a September 27, 1973 subcommittee print of H.R. 9142 (the 'Shoup-Adams bill')," and that under §§ 303(d) and 102(5) of the bill the consideration for the properties was to be "the greater of fair liquidation value or going concern value thereof as of September 30, 1973." The Trustees suggest that if Judge Fullam could have foreseen the design of the Rail Act as enacted, he would have insisted on some protection against further erosion as a price of not dismissing the § 77 proceedings.

Whether the court so relied on the formulation of a subcommittee print is open to question; Under Secretary of Transportation Barnum, who presented a report on the status of pending legislation on behalf of the Government parties at the October 12 hearing, did not mention the September 30 date in his statement, and other government parties specifically noted that "[t]he final form of that legislation remain[ed] to be threshed out." (Hearing transcript, Oct. 12, 1973 at 9869). By November 3, 1973, when H.R. 9142 was reported out by the House Commerce Committee, the provision on consideration had been modified to read

> either the fair liquidation value or going concern value thereof as of September 30, 1973, as provided in the final system plan, *except that in no event shall such rail properties be valued at more than the constitutional minimum required for their acquisition* . . . . (Emphasis added.)

and the accompanying House Report, H.R. Rep. No. 620, 93d Cong., 1st Sess., provided contradictorily at page 53 that "The value of the consideration must equal the fair and equitable value of the rail properties as of the date of the conveyance."

In any event, whatever the judge's desires might or might not have been, no one could give him any such guarantee as the PC Trustees suggest; the only alternative to deferring action that was open to him

was the truly unthinkable one of dismissing the § 77 proceeding just when Congress was on the verge of adopting comprehensive legislation in response to proposals advanced by the PC Trustees with his approval. Even if he had followed such a course and his action had not been stayed pending appeal, an equity receiver would still have had to apply for authority to sell or abandon unless abandonment was forced by the foreclosure of liens. *See United States* v. *27.7 Acres of Land*, 178 F. Supp. 712, 715 (W.D. Ark. 1959); Interstate Commerce Act § 1(3) ("common carrier" includes all natural or artificial persons engaged in transportation as common carriers for hire, and "persons" includes receiver of a company); *id.* § 1(20) (a "receiver . . . acting for" a carrier is liable to criminal penalties for authorizing or permitting any violation of § 1(18)).

31. The court qualified its holding by saying that statutory requirements of obtaining ICC and state commission approval apply "unless such statute inexorably conflicts with the Constitution" but that the record before it did not "demonstrate that such conflict has happened here—at least, not as yet." 485 F.2d at 215; *see id.* n.42. This also appears to have been the situation at the date of the October 12 hearing before Judge Fullam; at no time did he find that continued operation pending applications to the ICC for abandonment or sale under § 77(*o*) would constitute a taking forbidden by the Fifth Amendment in the absence of just compensation. In any event we have previously characterized this statement in the *Central Railroad of New Jersey* opinion as running "counter to the explicit assumption of all courts, including the Supreme Court in the New Haven Inclusion Cases." 384 F. Supp. at 920 n.33.

The Third Circuit's *Central Railroad of New Jersey* decision was followed in *In re Erie Lackawanna Railway*, 517 F.2d 893 (6 Cir. 1975). The court of appeals there reversed an order of the reorganization court, made before the EL became subject to the Rail Act, permitting discontinuance of two Ohio passenger trains where the Ohio commission had delayed for 10 months in acting on the trustees' discontinuance request and the trustees had not applied to the ICC for expedited relief under § 13a(2) of the Interstate Commerce Act. The case is less helpful to the Government parties than the *Central Railroad of New Jersey* decision in that the EL's financial condition at the time was less serious; however, the Sixth Circuit panel did extend the *Central Railroad of New Jersey* rationale to a situation in which an agency

application for discontinuance or abandonment was already pending, *per contra* 485 F.2d at 213.

Many transferors rely on the decision in the so-called Columbus Option case, *In re Penn Central Transportation Co.*, 494 F.2d 270 (3 Cir.), *cert. denied*, 419 U.S. 883 (1974), as dispensing with any requirement of application for authority to abandon. The issue there was quite different. The United States held $100 million of trustees' certificates issued under the Emergency Rail Services Act which constituted a prior lien on the Penn Central's mortgaged assets and also a lien on unmortgaged assets. The United States and the PC Trustees wished to have the proceeds of sale of unmortgaged assets used for operations; the mortgages objected that this would increase the impact of the prior lien of the United States on the mortgaged assets and thus would have a similar effect to use of proceeds of the mortgaged assets themselves and that, in the absence of a finding of prospects of a successful reorganization, this was forbidden by the rule of marshaling. The court sustained this claim. How far it was from upholding the position here advanced by transferors is shown by its remark concerning the Rail Act, 494 F.2d at 283:

> Congress, in devising a legislative solution, will be bound by the fifth amendment to pay the fair value of the Penn Central properties at the time any new rail transportation entity takes them. Any amount beyond that value, which would compensate secured creditors for the erosion which took place while the reorganization court and the ICC waited for a congressional solution, would be a matter of legislative grace. It would be hazardous, indeed, to speculate on the likelihood of favorable exercise of such largess from public funds, especially in view of the form of the legislation recently enacted. (Footnote omitted.)

32. During the course of the § 77 reorganization up to January 1973, the PC Trustees filed applications with the ICC for the abandonment of approximately 3,000 miles of line; applications for abandonment of about 800 miles were granted. We are not told what efforts the PC Trustees made, before the ICC's "freeze" on abandonment proceedings in 1973, *see* 384 F. Supp. at 921-22, to press the applications on which the ICC took no action.

33. The implication for the situation here of Judge Anderson's conclusion and the Supreme Court's seeming approval of it is all the

stronger in that during the two years from 1961 to 1963, when the New Haven was determined to be unreorganizable on an income basis, the Trustees had sought federal and state aid in the form of tax relief and subsidies to allow the New Haven to operate on a breakeven basis. 289 F. Supp. at 456. Despite the fact that no subsidies of adequate size were forthcoming from the interested states or the federal government, Judge Anderson did not consider that the government had lost its entitlement to an abandonment proceeding during which it could examine alternatives for continuing rail service if inclusion of the New Haven in the Penn Central had not seemed possible.

34. We likewise cannot subscribe to the argument that applications to abandon would have been futile in view of the logjam they would have created at the ICC and the "freeze" imposed by the Commission in 1973 and lifted in 1974, *see* 384 F. Supp. at 921-22. While the Commission could not reasonably be expected to deal with abandonment applications of the importance here under discussion in a fast-food manner, we cannot assume that if the Commission had been confronted with applications for total or large-scale abandonment by the PC and the other bankrupt railroads in the Northeast, it would have proceeded on a "business-as-usual" basis or refuse to proceed because of its temporary freeze. We repeat what Judge Adams said in *In re Central Railroad of New Jersey*, *supra*, 485 F.2d at 213 (footnotes omitted):

> There having been no application made, there can be no showing that delay or frustration would be the inevitable result.

35. In fact the record affords no basis for belief that the PC Trustees favorably considered abandonment beyond an 11,000 mile core until early 1973. As will later appear, we take that date, when serious discussion of what became the Rail Act began, as the date when the clock started to run against the Government in the case of the PC.

36. It can, of course, be argued that this burden should be shared by all citizens. But the problem was peculiarly that of the bankrupt railroads, and it seems as legitimate to saddle them with the cost of reasonable legislative as of administrative consideration.

37. Section 5(2) of the Interstate Commerce Act, which requires a rail carrier to seek ICC approval of any sale or lease of rail property to another carrier, would apply to any sale or leasing of rail properties to a state transportation authority that already operated a rail service handling cars moving in interstate commerce, even where the relevant

trackage was located wholly within the acquiring state. *See United States* v. *California*, 297 U.S. 175, 185-86 (1936); *National League of Cities* v. *Usery*, 44 U.S.L.W. 4974, 4980 n.18 (U.S. June 24, 1976); *compare* 45 U.S.C. §§ 1 and 6 ("any common carrier engaged in interstate commerce by railroad"), *with* 49 U.S.C. § 1.

38. We find additional support for this conclusion in Judge Anderson's finding, 304 F. Supp. at 801, and the Supreme Court's apparent approval of his finding, 399 U.S. at 460, 489-90, that an abandonment proceeding for the New Haven would have taken approximately three years, from late 1963 to December 31, 1966; the New Haven proceeding would have involved far fewer considerations of public interest and competitive effect than the abandonment of major eastern carriers that formed an essential adjunct to the services of other carriers serving the west and the south.

39. When we wrote in 1974, the fate of any initial FSP seemed in serious doubt because of the deep split in opinion between the Secretary of Transportation and the Rail Services Planning Office (RSPO) of the ICC over the treatment of low density lines and the popularity of the RSPO's position with local communities. The Secretary's 1974 report *Rail Service in the Midwest and Northeast Region*, Vol. I, at 3, 69-74, concluded that 25 percent of the region's railroad mileage was "potentially excess", because the number of freight carloads originated or terminated on those lines annually fell below the number judged by the Department of Transportation to be necessary for a "high probability of financial viability". Only the lines which had such a high probability were recommended for inclusion in the FSP at that time, with certain exceptions; the others were to be further studied, to see whether the 1972 standard data used was not accurate in the individual case, or whether tariff adjustments could improve their viability. But if the line was eventually found to be "excess", according to the Department's profitability criterion, its continued operation was said to be up to the States, local communities, and shippers, who might want to undertake subsidization of the line under § 304(c) of the Rail Act, or to acquire it.

As noted in our 1974 opinion, 384 F. Supp. at 921 n.36, the public hearings conducted by the RSPO on this report aroused great public reaction, in part because of uncertainty as to what was meant by the designation of a line as potentially excess, but in larger part because of disagreement with the use of line-by-line profitability as the sole criterion for continuation of service.

> Witness after witness described the adverse economic, social, and environmental impact such actions would have on communities. It was contended that rail service discontinuances would result in market distortions, economic depression and social dislocations. Moreover, it was repeatedly stated that rail discontinuance is inconsistent with our national environmental and energy conservation policies.
>
> * * *
>
> A number of witnesses took issue with the DOT Report's assumption that alternate modes of transportation could fill in the gap if major reductions in rail service were effectuated.

RSPO, *Evaluation of the Secretary of Transportation's Rail Services Report*, at 10 (May 2, 1974). The Planning Office's own recommendations were that USRA

> should reject the Secretary's method of determining branch line viability which was based primarily—if not solely—upon the number of carloads handled.

and

> should consider lines as segments of a total system and evaluate their capabilities for contributing to overall system efficiency, rather than requiring that each line or mile of track meet a test of independent profitability.

Id. at 3, 4. The fight over abandonment criteria continued during 1975, *compare* I Preliminary System Plan at 6, 15, 20 (February 26, 1975) *with* RSPO's *Evaluation of the Preliminary System Plan* at 6, 49-57 (April 28, 1975), but did not delay Congressional acceptance of the Final System Plan.

40. We do not mean this permission to be read as an open-ended invitation to burden these proceedings with consideration of possible abandonment of small branch lines now seem to be desirable by hindsight; we are referring to abandonments of major significance to a particular carrier, *e.g., the Ann Arbor's car ferry operations* (*see* Section V(E)), even though not of its entire property. The trustees would also have the burden of showing that they were in fact ready to propose such abandonments. *see* fn. 14 *supra*.

41. In the absence of some measure of agreement on the guidelines with respect to putative abandonment proceedings such as we urge in Section VI of this opinion, we shall doubtless wish to arrange a conference on this subject during the next few months. It may be that the taking of evidence with respect to the dates when abandonment applications would have been filed and should have been concluded should be confided to a single master or to a member of this court rather than assigned to a number of masters dealing with different properties. The project here suggested, however, may turn out to be so closely related to the problem of an "alternative scenario" to be discussed in our CMV opinion that, in the absence of agreement, the interests of all parties would be served by consolidating the two.

42. These sections authorized the Secretary of Transportation to provide funds to the railroads prior to conveyance. Section 213, as amended, provides for $282 million to be paid to railroad trustees "as . . . necessary for the continued provision of essential transportation services." Section 215, as amended, authorizes the financing with $300 million in obligations of agreements between the Secretary and the trustees for three purposes:

> (1) to perform the program maintenance on designated rail properties of such railroads until the date rail properties are conveyed under this Act;
>
> (2) to improve rail properties of such railroads; and
>
> (3) to acquire rail properties for lease or loan to any such railroads until the date such rail properties are conveyed under this Act, and subsequently for conveyance pursuant to the final system plan, or to acquire interests in such rail properties owned by or leased to any such railroads or in purchase money obligations therefor.

Funds under either section used for program maintenance or improvement of designated properties are subject to § 215(b)(1), which provides that

> to the extent that physical condition is used as a basis for determining, under section 206(f) or 303(c) of this Act, the value of properties subject to such an agreement and designated for transfer to the Corporation under the final system plan, the physical

condition of the properties on the effective date of the agreement shall be used . . . .

We have previously indicated that § 213 "provid[es] for grants rather than loans" and that § 215 advances "are not debts of the estates of the borrowing railroads, although they must be assumed by Conrail." *In re Penn Central Transportation Company*, 384 F. Supp. 895, 909 & n.17 (1974). The Government's brief, at 27, characterizes § 213 aid as "grants" and § 215 assistance as "loans to ConRail that for present purposes are effectively grants to the transferors." On March 31, 1976, the Secretary of Transportation and USRA agreed, pursuant to § 215(c), to release ConRail from all but approximately $43 million of the obligations incurred in financing the § 215 expenditures.

The following tables show what aid was provided each railroad:

§ 213

	Grants made	*Disbursements*	*Balance available under existing grants*
Penn Central	$187,718,003	$187,718,003	$ —
Central of New Jersey	22,320,000	22,320,000	—
Lehigh Valley	8,550,000	8,125,000	425,000
Erie Lackawanna	31,696,956	31,696,956	—
Ann Arbor	4,687,000	4,687,000	—
Reading	7,970,000	7,850,000	120,000
Lehigh & Hudson River	796,807	796,807	—
Total	$263,738,766	$263,193,756	$545,000

Source: Report of the Comptroller General of the United States (CED-76-161) (Nov. 15. 1976).

Appendix C

§ 215

	Approved Its Program	*Expenditures*	*Compounded Balance*
Funds Applied:			
Program Maintenance:			
Penn Central Agreement—754	$ 85,000,000	$ 83,412,677	$1,537,323
Penn Central Agreement—755	69,300,000	69,222,369	77,631
Erie Lackawanna Agreement—756	1,900,000	1,878,610	21,390
Erie Lackawanna Agreement—757	8,100,000	8,030,634	69,366
Central of N.J. Agreement—753	1,200,000	1,085,584	114,416
Central of N.J. Agreement—759	500,000	420,305	79,695
Reading Agreement—7513	50,000	-0-	50,000
Reading Agreement—7514	3,630,000	3,647,458	2,542
Lehigh Valley Agreement—7511	2,500,000	2,166,520	333,480
Lehigh Valley Agreement—7512	3,762,000	3,454,903	307,097
Program Maintenance, Total	175,962,000	173,319,060	2,642,940
Maintenance of Way Machinery:			
Penn Central Agreement—751	14,700,000	13,727,973	972,027
Erie Lackawanna Agreement—7516	110,000	95,331	14,669
Lehigh Valley Agreement—7517	500,000	494,906	5,094
Maintenance of Way Machinery, Total	15,310,000	14,318,210	991,790
Lehigh Valley Locomotives:	3,450,000	3,435,096	14,904
Equipment Obligations:			
Erie Lackawanna Agreement—7518	7,800,000	7,794,543	5,457
Reading Agreements 7521 & 7523	1,650,000	1,645,257	4,743
Penn Central Agreements 7522 & 7529	33,550,000	32,260,026	1,289,974
Ann Arbor Agreement—7531	90,000	85,510	4,490
Central of N.J. Agreement—7519	464,800	-0-	464,800
Equipment Obligations, Total	43,554,800	41,785,336	1,769,464
Maintenance & Equipment Program:			
Penn Central Agreement—7515	53,200,000	53,135,844	64,156
Interest Expense:			
Gross Expense		7,796,491	
Interest Income		689,500	
Net Expense	7,500,000	7,106,991	393,009
Capital Projects and MNV Cars:			
Penn Central Agreement—761	290,000	289,0000	1,000
Available for Other Use	733,200	-0-	733,200
Total	$300,000,000	293,389,537	$6,610,463
Cash in Bank		49,866	
Total funds applied		$293,439,403	

SOURCE: Third Annual Report of the United States Railway Association at 22 (June 30, 1976).

43. We do not think that the Penn Central gains anything from the additional claim that the government guarantee of its trustees' certificates under the Emergency Rail Services Act of 1970, 84 Stat. 1975, amounted to governmental aid forced upon it. These benefits were received at a time when the PC Trustees clearly contemplated a successfully reorganized railroad and urged enactment of a federal loan or guarantee scheme, *see* Hearings on Emergency Rail Services Legislation Before the Subcom. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess., at 496-509 (1970), as did PC management, *see id.* at 247, 251, 252, 268, 367, although the Penn Central Company submitted a separate statement opposing direct federal loans, *see id.* at 579-80.

The PC's reliance on the receipt in August 1973 of approximately $16 million in loans under the Emergency Rail Facilities Restoration Act of 1972, 86 Stat. 1304 (the "Storm Agnes" legislation), stands on even weaker ground unless one is willing, as we are not, to accept the proposition that the railroads' "cashlessness" claims are strengthened by efforts of the government to abate the effects of natural disasters. The funds provided in August 1973 were largely designed to restore railroad facilities to their pre-storm condition and not as part of a long-range response to the financial plight of the railroads.

44. Northeast Rail Transportation Hearings Before the Subcomm. on Transportation and Aeronautics, House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess., pt. 1, at 246 (1973).

45. We think this is so despite the absence of a uniform favorable response to the legislative proposals of 1973 by the various trustees. Our review of the congressional hearings held during 1973 convinces us that although none wholeheartedly welcomed the legislation that became the Rail Act, neither did any transferor except the CNJ Trustee object as clearly or as vociferously as some now claim. Certainly the Penn Central did not object with the fervor it now contends, *see* Hearings on Northeast Rail Transportation Before the Subcomm. on Transportation and Aeronautics, House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess. 245-54; Hearings on the Northeastern Railroad Transportation Crisis Before the Surface Transportation Subcomm. of the Senate Comm. on Commerce, 93d Cong., 1st Sess. 392-407, 888-902. Instead, the various trustees generally testified as to the condition of their respective roads and then in rather vague terms noted what features federal legislation for continued rail operation should contain, only some of which were at odds with the emerging Rail Act.

46. We likewise cannot accept the argument that the Rail Act itself was the Government's solution and all erosion after its passage thus must be a taking. The Rail Act was not a solution but rather afforded the framework for achieving one, and the total time spent in considering and implementing the law was not unreasonably long. How the case would stand with respect to erosion if the process of the Rail Act had not succeeded is an issue we happily need not decide.

47. The Norwich & Worcester Railroad, the nature of whose operation is described in *Norwich & Worcester Railroad* v. *United States*, 408 F. Supp. 1398, 1400 (1976), and the Peoria & Eastern Railroad, which was operated by PC under an agreement, have filed briefs in which they take the position that whatever disposition is appropriate for PC's CUE claims will be appropriate for them. We think it fair to allow these railroads, if so advised, to attempt the showing indicated in text *supra*.

48. Unhappily the Government parties did not favor us with detailed briefing with respect to these claims, including the characterizations by the several roads of their financial and reorganization histories on which they are based. As a result, although we have done our best to check and supplement the histories recounted in the Trustees' briefs from such materials as are available to us, we have had to rely in considerable part on the Trustees' submissions. Of course the Government is still free to take issue with any of these submissions if and when the Trustees attempt the showing we have required for entitlement to pre-conveyance CUE.

49. This phrase requires some elucidation in view of what seems to have been the prevalent assumption that the trustee of a losing railroad in a § 77 proceeding could disregard § 1(18) of the Interstate Commerce Act. As previously indicated we regard this assumption as erroneous except when cessation of operations would have been required by "cashlessness" or other circumstances beyond a trustee's control. However, in view of the climate prevailing in 1975, the phrase "would have filed for abandonment" should be read to include an application to the reorganization court for authority to cease operations.

50. Counsel construed the reservation as including post-bankruptcy tax claims together with any post-bankruptcy administration claims. *See* Transcript of argument, 124-25.

51. Authorization was later granted, *R. D. Timpany, Trustee of the Central Railroad Co. of New Jersey—Abandonment of Operation*

Between Phillipsburg, N.J. and Hudson, Pa., 342 I.C.C. 227 (1972), and the reorganization court then authorized abandonment with compliance by the trustee with certain conditions laid down by the ICC, *see In re Central Railroad of New Jersey*, 486 F.2d 1124, 1126 (3 Cir. 1973), *cert. denied*, 416 U.S. 938 (1974).

52. After rejecting the claim that it was bound to follow the decision on the Pennsylvania abandonment as "law of the case" and *stare decisis*, the en banc court distinguished the earlier decision on the ground that there applications for abandonment were pending and the ICC "arguably unduly delayed" action on them. 485 F.2d at 210-11.

53. To wit, the LV, the Reading and the Western Maryland.

54. The reorganization court's denial of leave to the State of Pennsylvania and its Public Utility Commission to seek judicial review of these ICC decisions in another district court was affirmed by the Third Circuit, which noted that no appeal had been taken from the reorganization court's order sanctioning the CNJ's retirement from Pennsylvania and that the reorganization court could have convened a three-judge court under the Urgent Deficiencies Act, former 28 U.S.C. §§ 2321-25, if timely application to it had been made. *In re Central Railroad of New Jersey*, 486 F.2d 1124 (3 Cir. 1973), *cert. denied*, 416 U.S. 938 (1974).

55. These included negotiations with the Chessie for a lease of CNJ's freight facilities; a merger with LV and the Reading; and other discussions between the Trustees of the LV and the CNJ.

56. The Trustee admits that a contributing factor to the breakdown in these negotiations was the defeat of Governor Cahill of New Jersey in the Republican primary in June 1973 and his administration's subsequent understandable position that any changes in the contract should be left to his successor. We fail to see how the United States has any responsibility for this; the CNJ operates in a democracy and must take such interregna as part of the process.

57. The Trustee's Preliminary Plan of Reorganization, dated June 15, 1973, contemplated the filing by November 23, 1973 of either a plan of reorganization or, should federal relief not be forthcoming, a petition for cessation of operations and liquidation.

58. Substantially the same point was made by the Commonwealth of Pennsylvania in the Reading's reorganization court: in its memorandum in opposition to the Institutional Investors Reading Group's amended petition, the State argued among other things that cessation required a § 1(18) certificate and that the ICC must pass on any reorganization plan.

59. The Reading also argues that by December 1, 1973 it was entitled to cease operations and commence liquidation without any further judicial or administrative proceedings since at that time the road lacked sufficient reserves and current assets to cover operating expenses (including those necessary for liquidation) and leave enough capital for an orderly liquidation. An affidavit of John A. Brennan, Jr., submitted in support of this claim, indicates that the Reading has included in the "current liabilities" taken into account liabilities that would become current upon cessation, equipment obligations due within one year, and a large item for unspecified "miscellaneous" liabilities. In addition, this affidavit points to the Reading's receipt of §§ 213 and 215 funds as staving off a forced cessation in 1975 and the first quarter of 1976. Apart from the fact that the Reading's claim of "cashlesness" as to December 1, 1973 seems to go beyond the exception we would recognize for truly forced cessations, the role of governmental assistance in preventing cessation no more favors the Reading than it does for Penn Central.

60. The Reading further claims an independent right to CUE from January 1, 1975 on the ground that from then onward § 213 funds were made more freely available to the other roads than to it because of the Reading's comparatively strong cash reserves. We do not see, however, how this allegedly "discriminatory" application of § 213 gives rise to any special entitlement to CUE. If the Reading depleted its cash reserves during this period, then it can include this as an element of erosion for which it will be entitled to compensation if it can make the showing we describe in text necessary for any CUE payments. A railroad has no special right to erosion compensation because its continued operation had a particularly severe impact on one category of its assets -- in the Reading's case, cash.

61. In light of our discussion above of this general argument, we need not further discuss the LV claim that the Trustees' 1973 termination petition demonstrates a cash position that entitled it to immediate

cessation of operations as of October 1, 1973 within footnote 31 of our 1974 opinion.

62. In 1966 overhead loaded traffic constituted 96.1% of the L&HR's business. By 1972 the proportion had fallen to 83.6%, as a result of loss of the bridge traffic rather than any significant increase in originated or terminated traffic.

63. The L&HR had no mortgage liens.

64. All told EL received $27.9 million in grants for wages and operating costs and $3.8 million for equipment obligations under § 213 and $7.8 million for such obligations and close to $10 million for maintenance of its properties pursuant to § 215 — an aggregate exceeding $49 million.

65. Indeed, as the Government parties argue, it is quite remarkable that EL's belated entry did not force USRA to request a further delay for the submission of FSP.

66. Some support for the latter alternative may be found in § 3(b)(4) of the Emergency Rail Services Act of 1970, 84 Stat. 1976, which provided that the Secretary of Transportation, after consultation with the ICC, shall require as a condition to a government guarantee of trustee certificates under the Act that

> in the event of actual or threatened cessation of essential transportation services by the railroad, the Secretary shall have the option to procure by purchase or lease trackage rights over the lines of the railroad and such equipment as may be necessary to provide such services by the Secretary or his assignee, and, in the event of a default in the payment of principal or interest as provided by the certificates, the money paid or expenses incurred by the United States as a result thereof shall be deemed to have been applied to the purchase or lease price. The terms of purchase or lease shall be subject to the approval of the reorganization court and the operation over the lines shall be subject to the approval of the Commission pursuant to the provisions of section 5 of the Interstate Commerce Act, but in no event shall the rendition of services by the Secretary or his assignee await the outcome of proceedings before the reorganization court of the Commission.

Another possibility was the ICC's legislative proposal, H.R. 6591, which provided for a lease and leaseback arrangement between the bankrupt lines and the United States for a period not to exceed three years with the difference between revenues and operating costs subsidized by the federal government. *See Penn Central Transportation Company Reorganization,* 347 I.C.C. 45, 121 (Sept. 28, 1973).

67. The House Report, H.R. Rep. No. 620, 93d Cong., 1st Sess. 28 (Nov. 3. 1973), accompanying H.R. 9142, set forth the basic views of the Committee on Interstate and Foreign Commerce concerning a federal solution as follows:

> This Committee decided from the beginning that any legislation it would report to the House would not be a "Creditors Relief bill." The Committee feels that in our free enterprise system, investments should be made freely without a public guarantee that the investment will reap profits for the financier. The investors and creditors of the bankrupt carriers took certain business risks and should not expect the American taxpayer to "bail them out" merely because their investments were failures. And too, the investors, and creditors of railroads know before they make such investments of the traditional and historic "public interest" character of the industry. In short, the investment fortunes of a few cannot override the economic fate of the nation.
>
> The Committee also decided that the public interest would not be served if these bankrupt carriers were shut down and sold on the "auction block." The services these carriers perform are essential to the nation and the blow to the economy if such services were interrupted only briefly, would be devastating. This is a matter which affects not only the economy, but also the defense needs of the nation. The future of rail transportation in the Northeast transcends the interests of not only the investors, the creditors, the managers and trustees, and the people and the industries of the Northeast region—it is an American problem, one affecting all of us.
>
> The Committee further decided that the economy could not sustain nationalization of the rail industry in the North, nor would it be good public policy. The Committee fervently believes that private enterprise must flourish in the transportation industry, and that it would set a precedent for not only the rail industry, but all transportation needs, if the government became the owner and operator of the Northeast rail carriers.

> Recognizing the public necessity of a viable, functioning rail system, and the importance it has in our nation, the Committee acknowledges that some federal assistance is an absolute necessity to assist in the restructuring of the system. No one judge can accomplish the complex restructuring of all rail carriers in the region, and the problem cannot be isolated by individual carrier—all bankrupt carriers in the region must be considered in any legislature solution.

Similarly, referring to the use of a new corporation's securities to pay for the transferred properties and use of federal loan guarantees instead of grants, the report of the Senate Committee on Commerce S. Rep. No. 601, 93d Cong., 1st Sess. 18 (Dec. 6, 1973), accompanying S.2767, explained that "the very process by which the bill would create a new healthy railroad out of the bankrupt ones arose from th[e] strong desire to limit the use of Federal money." Congress was rather clearly concerned with minimizing the cost to the federal government and avoiding the perception of either a "bail-out" or "nationalization": these concerns would hardly have engendered federal responses that would have put the erosion burden as well as the conveyance cost squarely on the federal government.

68. Our many references to the need of proving the consummation of an abandonment or sale are not to be taken as excluding proof that a purchaser might have obtained authority to operate on an interim basis or have agreed to absorb part or all of interim losses.

69. Agreements of this sort could, of course, be without prejudice to the rights of either side to have the basic elements of our decision with respect to the accrual of pre-conveyance CUE reviewed by the Supreme Court.

APPENDIX D

Appendix D

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Special Court—Misc. No. 76-1

Filed July 5, 1977, James F. Davey, Clerk

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

On Motions for Reconsideration of Opinion of April 19, 1977 on Compensable Unconstitutional Erosion (CUE).

PER CURIAM:

On April 29, 1977 the PC Trustees moved for reconsideration of our opinion of April 19, 1977, dealing with compensable unconstitutional erosion (CUE). A number of other transferors and the PC Company joined in the motion. Because of uncertainty as to the proper date for seeking reconsideration of rulings of this court, we issued a notice fixing May 25, 1977, as a date by which motions for reconsideration of our CUE opinion could be filed and permitting the Government parties to answer by June 7. A number of other parties subsequently joined in the motion of the PC Trustees, the Government parties filed a response, and the PC Trustees and others, with our permission, have filed a reply.

Although the PC Trustees, stating their intention to raise on appeal their disagreement with the "basic framework" of our opinion, limit themselves to three grounds hereafter discussed, we think it wise also to advert to their preliminary criticisms that "the Court had no basis on the record, for example, for suggesting

that the cessation of operations by Penn Central would necessarily have required environmental impact statements, or for now expressing its conviction that '. . . it would have been impossible [for Penn Central] to complete abandonment proceedings before April 1, 1976.' (Op. at 37.)" Although the need for environmental impact statements with respect to abandonments effected through ICC proceedings has been taken as a given in all this court's proceedings, see *180-Day Appeals*, 384 F. Supp. 895, 922 (1974), if the PC Trustees or others wish to attempt showings that such statements might have been dispensed with, they are free to do so. Similarly, our remark as to the impossibility of obtaining ICC authority to abandon the entire PC operation by April 1, 1976 even if an application had been filed early in 1973 expressed our strong conviction; it should not be taken as precluding an attempt at contrary proof, see Op. at 39.

We turn now to the three specific points urged in the motion:

(1) The PC Trustees ask us to make clear that, in connection with efforts to demonstrate the feasibility of a cessation of operations prior to April 1, 1976, we should allow proof that the transferors would have become "cashless" prior to that date and, indeed, that the Government parties should have the burden of proving that they would not have. This argument is based on a misunderstanding of pp. 41-43 of our opinion. In the absence of the Rail Act, the transferors' "Brooks-Scanlon rights" would have accrued on a cessation of operations (a) for which the ICC had granted leave or at the end of a reasonable time for the ICC's acting on applications for such leave, or (b) on the transferors' attaining "cashlessness," whichever was earlier. We held there would be no erosion taking if the Government, by providing emergency financial aid, postponed (b) to—but not beyond—(a). The notion of hypothetical applications for leave to cease operations (including the qualification that, generally speaking, these may be considered to have been filed in early 1973) was used by us to determine how long the Government could constitutionally

require operation even after what, absent the Rail Act, would have been the point of cashlessness. It is thus irrevelant that, as the PC Trustees contend, absent the Rail Act or some other form of interim assistance, they would in fact have reached the point of cashlessness before an application for leave to cease operations could have been carried to a conclusion and operations were discontinued.

(2) The PC Trustees' second point is that in light of the ICC's decisions in *Okmulgee Northern Ry. Co. Abandonment*, 320 I.C.C. 637 (1964), which had not been called to our attention in the briefing on CUE, and subsequent ICC cases, we were in error in supposing that an application for sales to other railroads or, in some instances, to public bodies would have required approval under § 5(2) of the Interstate Commerce Act, see Op. at n.37. The PC Trustees read these cases as holding that when the applicant is seeking to abandon all of its railroad operations, authority under § 1(18) [now slightly amended as § 1a(1)] is all that is required. The Government parties question the correctness of *Okmulgee* and its progeny and their applicability to transactions of the magnitude that would have here been involved. As the Government parties also suggest, there is no need to determine these questions until we know what the transferors say they would have proposed. If they wish to contend that the ICC could have authorized these solely under § 1(18) and that this would have been materially different from authorization under § 5(2) in procedure or result, they are free to do so.

(3) The final point made by the PC Trustees, namely, that the Rail Act itself operated as an erosion taking, was fully considered by us, see Op. at n.46, and we find no need for further discussion of it.

Appendix D

Except as herein indicated, the motions for reconsideration are denied. In light of § 303(d) of the Act and the summer recess of the Supreme Court, we shall postpone the effective date of this order of denial until November 1, 1977.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: July 5, 1977

APPENDIX E

Appendix E

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Misc. No. 76-1

Filed October 12, 1977, James F. Davey, Clerk

In the Matter of the
Valuation Proceedings under Sections 303(c) and 306
of the Regional Rail Reorganization Act of 1973

Before:

FRIENDLY, *Presiding Judge*, and
WISDOM and THOMSEN, *Judges*.

Opinion with respect to issues set for briefing and argument as Subjects (4) and (6) of Schedule attached to Memorandum and Order of June 16, 1976, 425 F. Supp. 266, 289 (Sp. Ct. 1976), as supplemented by Notices of December 15, 1976 and April 14, 1977.

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Appendix E

FRIENDLY, *Presiding Judge:*

I. *Introduction*

In this opinion we continue the discussion of the nature of the Rail Act in Part III of our opinion of October 18, 1976, 425 F. Supp at 270-71, and shall consider the constitutionality of compensating the transferors in other than cash, an issue on which we requested briefing by our notice of April 14, 1977. We shall also deal with certain of the issues outlined in our Memorandum of June 16, 1976, 425 F. Supp. 266, 281-87, relating to the determination of net liquidation value (NLV) under § 306 of the Rail Act, of constitutional minimum value (CMV), and of value of other benefits (VOB). In accordance with our Memorandum of June 16, 1976, 425 F. Supp. at 289, opening briefs on the issues of NLV, CMV, and certain other matters were received on January 6, an answering brief of the Government parties on February 20, and reply briefs on March 18, 1977. By order of December 15, 1976, we set a schedule with respect to the VOB issue which required initial briefs to be exchanged on February 22, 1977 and further briefs on March 18, 1977. We heard oral argument on April 12 and 13, 1977. In the meanwhile, discovery has been continuing under the supervision of Judge Thomsen.

As indicated in the Memorandum of June 16, 1976, 425 F. Supp. at 277-78, the court believed that extensive briefing and argument of certain general questions at this time would permit us to announce our views with respect to a number of legal issues and enable us to establish procedures for the further conduct of the necessarily complex valuation proceedings required by the Rail Act, and thereby reduce the time and expense, huge under the best of circumstances, which will be required to conclude this case. We thought then, and we think now, that simply to appoint a number of special masters who would be set loose without any guidelines from us "would produce utter chaos," 425 F. Supp. at

277.[1] We remain convinced of the wisdom of proceeding in the manner outlined in our June 16, 1976 Memorandum, even though it now appears that decision on some issues that have been briefed would be premature. Even as to such issues the efforts of counsel will not have been wasted, since these questions, or most of them, will have to be decided at a later date.

II. *Reorganization* v. *Eminent Domain: The Propriety of Compensation Other than Cash*

In our memorandum of June 16, 1976, we noted that "a question lurking in the case is whether the standard of valuation should be different if the Act be regarded as a reorganization statute, as an eminent domain statute or as both," 425 F. Supp. at 280 (footnote omitted), and requested that this issue be included in the first round of briefing. Responding to such briefing in our opinion of October 18, 1976, 425 F. Supp. at 270-71, we said that perhaps the question could be more accurately stated as being whether the Act involves a taking and, if so, whether the 'constitutional minimum' required both by the terms of the Act and by the Fifth Amendment differs if the Act should be regarded as a reorganization statute enacted under the bankruptcy power or as a statute enacted under the commerce power or as both. For reasons there developed, we deferred decision until after the final round of briefing and argument called for by our June 16 Memorandum.

The issue has lost much of what once seemed to be its significance because of the concession of the Government parties (Brief at 12):

---

1. We say this despite our recognition that any determinations made by us are subject to review by the Supreme Court. Section 303(d) of the Rail Act, as we read it, would permit the Court to review this opinion now, despite its interlocutory character, if the Court should deem that to be wise—a question on which, of course, we intimate no view.

> We do not contend that the Act cannot involve a "taking" or that the Fifth Amendment standard differs depending on which powers Congress invokes.

See also id. at 14-15. Indeed, it now appears that the chief, if not the sole, importance of the question how far the Act is a reorganization statute may be in its bearing on the issue framed in our notice of April 14, 1977:

> whether payment in the manner provided in the Rail Act, namely, that net liquidation value shall be paid in securities of ConRail and certificates of value and that only the excess of constitutional minimum value, if any, as finally determined, shall be paid in cash, is constitutional.[2]

A large step toward answering this question was taken by the Supreme Court in the *Rail Act Cases*, 419 U.S. 102 (1974). The plaintiffs there asserted

> that the Rail Act is basically an eminent domain statute and, because compensation is not in cash but largely in stock of an unproved entity, will necessarily work an unconstitutional taking. A variant of the argument is that, even if a reorganization statute, the Rail Act would be unconstitutional unless the Tucker Act remedy is now held to assure payment of any amount by which the *market value* of stocks and securities awarded by the Special Court is less than the value of the rail properties conveyed.

419 U.S. at 137 (emphasis in original; footnote omitted).[3] The Court held that the bankruptcy power authorized Congress to provide a mix of ConRail securities and USRA obligations in

2. The Notice also requested discussion whether a distinction should be drawn between bankrupt and nonbankrupt transferors or between specific classes of nonbankrupts.

Briefs were received on June 1 and reply briefs on June 22, 1977.

3. The Supreme Court elsewhere stated that the plaintiffs' "principal contention" was, in part,

payment for the properties to be conveyed to ConRail[4] and that any taking compensable in cash was limited to the "shortfall" between the value of the properties and the value of the consideration which the Rail Act provided, 419 U.S. at 150-56. Although, as a result of the 1976 amendments' substitution of the certificates of value (CV's) for the USRA obligations provided in the Rail Act as initially adopted,[5] the "shortfall" will be different and, in all probability, less, the Supreme Court's analysis remains broadly applicable.

> that the ConRail securities and USRA obligations and other benefits to be received would not be the constitutionally required equivalent of the rail properties compelled by § 303(b) to be transferred.

419 U.S. at 117-18. *See also id.* at 147:

> [W]e hold ripe for adjudication the questions . . . whether stocks, however valued, can be part of the consideration for the rail properties. . . .

4. In light of the Government's concession referred to above, the problem of the respective reaches of the bankruptcy and commerce power has no practical importance with respect to properties conveyed to profitable railroads or to states. In those instances, the transferors will receive compensation in cash from the transferees. *See* Sections 206(d)(2), 303(a)(2). If this Court finds that the terms of any such transfer are not fair and equitable, it is to enter a judgment against the transferee. Section 303(c)(3). The United States will be required to indemnify the transferee against the costs of any such judgment. Section 303(c)(5).

5. Section 210 of the Regional Reorganization Act of 1973 authorized the Association to issue obligations, guaranteed by the Treasury, not to exceed $1.5 billion, of which $500 million could be used for acquisition of the properties of railroads in reorganization. *See* H.R. Rep. No. 93-744, 93d Cong., 1st Sess. 60 (1973). The 1976 Amendments limited the amount of USRA obligations, restricted their use to loans pursuant to § 211, and created certificates of value. We described the workings of these certificates in our June 16 opinion, 425 F. Supp. at 276-77. In essence, they are a means of ensuring that the transferors receive obligations carrying the full faith and credit of the United States for the net liquidation value (NLV) of their property, independent of the Tucker Act remedy for any excess of constitutional minimum value (CMV) over NLV. Indisputably the transferors are better off with the CV's than with the limited amount of guaranteed USRA obligations they could have received under the 1973 Act.

Various transferors[6] point out that the only estate before the Court in the *Rail Act Cases* was the Penn Central (PC) and that the decision thus is not conclusive on other bankrupt estates and certainly not on the nonbankrupts. Certain bankrupt transferors contend that while the Court could fairly have concluded that the Rail Act was in part a reorganization statute as to the PC in view of its preponderant share in the properties to be conveyed to ConRail and the ConRail securities to be received, the situation of the other lines is quite different since the ConRail securities will represent predominantly the earning power of PC's transferred properties whereas their properties may have proportionately higher earning power and that this disparity would not necessarily be taken care of by the allocation of the ConRail securities issuable in consideration of the conveyances since they would still be afflicted by the assumed low earning power of the PC assets. The non-bankrupt transferors repeat this argument and further contend, citing *Callaway* v. *Denton,* 336 U.S. 132 (1949), that the bankruptcy power does not extend to them; they refer to the Government's concession on the 180-Day Appeals, which we have permitted it to withdraw, *Norwich & Worcester R.R.* v. *United States,* 408 F. Supp. 1398, 1405 (Sp. Ct. 1976), "that no contention was being made that the acquisition of rail properties from nonbankrupts would be on any other than an eminent domain basis," *see* Final System Plan (FSP), Vol. I at 127-28.

The first contention need not detain us long. While the Supreme Court's decision is conclusive only with respect to PC, the Court was well aware that the Rail Act operated similarly with respect to the other bankrupt railroads, *see* 419 U.S. at 108-17; if the Court had thought that the Rail Act must be characterized differently as to the other bankrupt estates, it surely would have said so or at least entered a *caveat,* particularly since in our opinion in the 180-Day Appeals, 384 F. Supp. 895, 951-52 (Sp.

6. We include in the word "transferors" the intervenors allied in interest with them, 425 F. Supp. at 288.

Ct. 1974), with which the Court was entirely familiar, we had dealt with and rejected a contention very similar to that here considered. Far from qualifying its holding, the Supreme Court flatly stated,

> [W]e believe that there is nothing in the Act fundamentally at odds with the expressed purpose of Congress to supplement the reorganization laws, see H. Rep. 29, and, with the Tucker Act, the Rail Act is valid as a reorganization statute.

419 U.S. at 150.

In contrast, the nonbankrupts are right in saying that, in light of the concession of the Government parties in the 1974 proceedings, noted in the portion of this Court's opinion written by Judge McGowan, 384 F. Supp. at 963-64, that any taking of their properties under the Rail Act would be an exercise of eminent domain, our decision in the 180-Day Appeals cannot be read as holding that as to them the Act was in part a reorganization statute and that a taking occurred only with respect to the "shortfall" between the constitutional minimum value of their property and the value of the consideration they ultimately will receive. We shall likewise assume in their favor that the Supreme Court did not consider whether its analysis would apply to them. However, we now hold that as to them also the Rail Act is a valid reorganization statute and that payment may be made in securities of ConRail and CV's with cash payable only for any "shortfall." While Congress recognized the distinction between bankrupt and nonbankrupt railroads, *see* § 303(c)(1)(A), and directed this Court to make separate findings regarding the constitutional minimum value of profitable railroads, *see* H.R. Rep. No. 93-744, *supra* at 59 (1973), the Act in other respects applies equally to the rail properties of "railroads in reorganization in the region," § 206(c)(1), and to "railroads leased, operated or controlled by any railroad in reorganization in the region." *Id.*

The nonbankrupts had agreed that their properties should be operated, in most cases for many years as an integral part of railroad systems that are now bankrupt. These roads depended financially on rental or similar payments from the bankrupts. Most, although not all, were controlled by the bankrupts, a considerable number to the extent of being wholly owned.[7] As the Government parties note (Brief at 246, n.286):

> Few of the nonbankrupts employed their own personnel or operated their own rolling stock; and most, according to their financial statements, passively received income from sources such as rentals, dividends, interest, and the sale of property. Many were "profitable" only because they continued to state uncollected rentals as income.

The nonbankrupts formed an integral part of the bankrupt systems; indeed the shipping and traveling public had no notion of their separate existence. Most of them had no rolling stock and for this and other reasons could not be operated except in connection with the bankrupt system of which they had so long formed a part[8] to the extent that they could have resumed independent operations, this is one of the options foreclosed by the Rail Act to be considered in determining the NLV and CMV and, accordingly, the extent of the "shortfall." In exercising the bankruptcy power Congress may act on the basis of reality rather than under

7. Of 52 nonbankrupts, 42 were controlled by primary debtors or their subsidiaries, and 22 of these were 100% owned by primary debtors. Of 31 leased lines, 20 had leased their properties to a primary debtor in perpetuity or for terms of 999 or 990 years, and an additional nonbankrupt was under a 401 year lease.

8. For example, neither the Norwich & Worcester nor the Little Miami railroads had operated their own lines for over 100 years before enactment of the Rail Act. North Pennsylvania Railroad had not operated its line since 1879. As of December 31, 1973, the Norwich & Worcester had three employees. On the same date in 1974, the Northern Pennsylvania also had three employees; the Philadelphia, Germantown & Norristown Railroad had one. And as of December 31, 1975, the Baltimore & Eastern Railroad had three employees, the Little Miami, two. *See Moody's Transportation Manual* (1976).

the constraints of corporate forms that had no substantial meaning to anyone until the northeastern railroads underwent a financial crisis which imperiled their continued operation in the public interest. It is appropriate to quote Mr. Justice Sutherland's remarks in *Continental Bank* v. *Chicago, Rock Island & P. Ry.*, 294 U.S. 648, 668, 671 (1935):

> From the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power.
>
> . . . And these acts, far-reaching though they may be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.

Cf. Capital Telephone Co., Inc. v. *FCC*, 498 F.2d 734, 737 (D.C. Cir. 1974), where the court permitted the FCC to "look beyond the corporate entity" in order to achieve the "fair and equitable distribution of radio service" mandated by the Communications Act.

Callaway v. *Benton, supra*, 336 U.S. 132, is not to the contrary. As we observed in *Norwich & Worcester R.R.* v. *United States, supra*, 408 F. Supp. at 1404-05, that case "does not hold at all that the bankruptcy power could not extend to the rail properties of solvent lessors of railroads in reorganization. So far as here relevant, it held only that § 77 of the Bankruptcy Act did not purport to do so."[9]

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9. The nonbankrupts also rely on the statement of the court of appeals in *Benton* v. *Callaway*, 165 F.2d 877, 882 (5 Cir. 1945), *aff'd*, 336 U.S. 132 (1949), that

> A solvent corporation, which has appeared specially as creditor and lessor in a reorganization proceeding, cannot be constitutionally compelled against its will to convey to the debtor a larger and better title than was granted in the lease.

Appendix E

The considerations that led the Supreme Court to conclude in the *Rail Act Cases* that securities of ConRail and obligations of USRA might constitutionally be used as payment for the assets compelled to be transferred, with a cash award only for any "shortfall" between their value and the just compensation required by the Fifth Amendment, thus support the same conclusion with respect to the ConRail securities and CV's provided for in the amended Act not only as to the PC, the carrier before the Court in the *Rail Act Cases*, but as to all transferors, both bankrupts and nonbankrupts. Indeed, we would reach this conclusion independently. As the Court observed, 419 U.S. at 150:

> No decision of this Court holds that compensation other than money is an inadequate form of compensation under eminent domain statutes.

The one federal case and the state cases cited by some transferors as so holding are not impressive. Most of them were decided many years ago and evince attitudes reflective of an earlier stage in the development of the economy when compensating a condemnee in securities would force him to resort to an imperfect, discontinuous market to retrieve their value. In some, the state attempted to compensate the condemnee with land, *e.g.*, *Vanhorne's Lessee* v. *Dorrance*, 2 Dall. 304, 315-16 (Cir. Ct., Pa. Dist. 1795); *Groce* v. *Greenville, S. & A. Ry.*, 94 S.C. 199, 202, 78 S.E. 888, 889 (1913); *Reynolds* v. *State Board of Public Roads*, 59 R.I. 120, 194 A. 535 (1937); *Shurtleff* v. *Salt Lake City*, 96 Utah 21, 23, 82 P.2d 561, 562 (1938), or by affording

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In our view this reliance is misplaced. The court of appeals had previously noted that, "The jurisdiction of the federal district courts sitting in bankruptcy is limited to matters conferred by statute expressly or impliedly." *Id.* at 880. The finding that no such jurisdiction over the fee interest in defendant's property had been conferred compelled the conclusion that the district court could not constitutionally order the conveyance, since no court may constitutionally act beyond its jurisdiction. Here, there is no doubt that the Rail Act confers jurisdiction over the property of a nonbankrupt lessor. If the court of appeals meant more than what we think it did, we would be constrained to disagree.

the right to use the same or other property taken, *e.g.*, *State* v. *Smith*, 25 Wash.2d 520, 544-45, 171 P.2d 853, 855 (1946). Other cases were decided under state constitutional provisions which expressly or impliedly required compensation to be paid in money, *e.g.*, *Martin* v. *Tyler*, 4 N.D. 278, 292-93, 60 N.W. 392, 397 (1894); *Gardiner* v. *Henderson*, 103 Ariz. 420, 424-25, 443 P.2d 416, 420-21 (1968) and thus have no relevance to an interpretation of the just compensation clause of the Fifth Amendment.

We shall not attempt to discuss in detail all of the decisions the transferors have cited. We note only that the transferors would have us mechanically apply the rulings of these cases while ignoring their underlying rationale—that the compensation required by the Fifth Amendment must be sure and certain and equivalent in value to the property taken. The payment scheme of the Rail Act complies with that requirement. The CV's "constitute general obligations of the United States of America for the payment or redemption of which its full faith and credit are pledged." § 306(a). The value of such a certificate, carrying 8% interest and redeemable not later than December 31, 1987, § 306(c)(1), can readily be computed by reference to other Government obligations for which a wide market exists. The method for determining the market value of the ConRail securities, which is to be deducted in fixing the base value of the CV's § 306(c)(5), accords with commercial practice; while there is some risk that these securities may be overvalued, there is equal risk that they may be undervalued. Experience has taught us that cash itself may fluctuate in value. Application of the Rail Act, with supplementary resort to the Tucker Act if needed, will afford the transferors "a full and perfect equivalent of the property taken," *Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 326 (1893). The Constitution requires no more.

Appendix E

III. *Net Liquidation Value (NLV)*

We deal in this section with a variety of questions relating to the determination of net liquidation value under § 306 of the Act relating to the certificates of value (CV's). It is well to emphasize that these are questions of statutory construction, not of constitutionality; we will consider the constitutional questions in Part IV.

(1) *DOT's contention that NLV is limited to scrap value*

We begin with the contention of the Department of Transportation (DOT) that the only kind of liquidation contemplated by Congress for the purpose of fixing the face value of the CV's would be a liquidation for scrap. The principal basis for this claim is that when Congress adopted the amended Act in 1976, the only theory of liquidation value which was before it was the discussion in the *New Haven Inclusion Cases*, 399 U.S. 392 (1970), which DOT argues proceeded on a scrap value theory. This is an insufficient basis for so restrictive a reading in the absence of any expression by Congress that it meant us to fix NLV on that basis alone. "Liquidation," as used in common speech, connotes all available methods of disposition, including but not limited to disposition for junk.[10] Moreover, the Supreme Court's *New Haven* opinion did not proceed exclusively on a scrap value theory. In its discussion of the Bronx freight yards, the Court found that trackage and electrical facilities in the yard would not have been dismantled, but rather maintained for continued rail use. "It is not rational," the Court stated, "to suppose that the managers of the hypothetical liquidation sale, devoted to obtaining the highest possible price for the assets of the debtor,

10. *Ballantine's Law Dictionary* 743 (3 ed. 1969) broadly defines liquidation as "the winding up of a corporation, partnership, or other business enterprise by converting the assets to money, collecting accounts receivable, paying debts, and distributing the net proceeds, if any among the shareholders, partners, or owners of the business." *Webster's New International Dictionary* 1441 (2 ed. 1960) adopts a similarly general definition, "To convert into cash by selling."

would have ignored the best use of the yard facilities and stripped them of more than $4,000,000 in value." 399 U.S. at 456-57 (footnote omitted). Congress was told in the FSP, Vol. I, at 125, that the Master Liquidation Plan (MLP) assumed "that the estates would be required to sell substantial assets for continued rail use" and that "the liquidation plan postulated by USRA is for an orderly transfer of the transportation services to other railroads. . . ." While the FSP added that "the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses," *id.*, and that the prices of transfers to other railroads would be "computed as if the estates had actually been allowed to exercise their asserted rights to liquidate by selling all their assets for non-rail uses," *id.*, the FSP furnished no explanation for this strange assumption, and there is no indication that Congress endorsed it.

(2) *The transferor's contention that for purposes of determining NLV, the United States may be regarded as a purchaser*

At the other extreme, we likewise reject the contention of the Trustees of the Penn Central that the directive in § 306(c)(4) that net liquidation value be "determined by the special court" gives us free rein to incorporate into NLV our guess as to what the United States would have paid for the properties if the Rail Act had not been enacted.[11] We here rely in considerable measure on the legislative history of § 306, reviewed in Part V of our Opinion of October 18, 1976, 425 F. Supp. at 274-75.

First, the House Report on the 1976 Amendments stated that the Committee concurred with USRA's general approach toward valuation, H. R. Rep. No. 94-725, 94 Cong., 1 Sess. 90 (1975), and intimated that this Court should be guided, although it would not be bound, by that approach:

11. The Lehigh Valley Trustee apparently concedes that NLV does not encompass potential sales to the Government. Brief at 6-9.

> While the Committee finds persuasive the Association's particular methodology in arriving at its estimates of net liquidation values, it also recognizes that these determinations must be left to ultimate judicial review and determination.

Id. Although as indicated in the previous section of this opinion, Congress cannot be supposed to have endorsed every statement in the FSP's analysis how NLV would be determined, it surely did not mean us to depart so far from the Association's "particular methodology" as to regard the Government as a prospective purchaser and to guess what it would have paid. As noted above, the FSP stated, "In essence, then, the liquidation plan postulated by USRA is for an orderly transfer of the transportation services provided by the estates *to other railroads*. . . ." Vol. I, at 125 (emphasis added).

Second, we may look to the *New Haven Inclusion Cases* as some evidence of the type of liquidation Congress had in mind for purposes of determining NLV.[12] While, as we have noted, that decision does not support the notion that only scrap value can be considered in determining NLV, it contains no hint that the Federal Government could have been considered as a potential purchaser of the New Haven's assets.

Beyond all this, whatever may be the proper characterization of the role which Congress intended for the United States under the Rail Act, it was certainly not that of a "willing buyer." It

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12. Indeed, Congressman Rooney, chairman of the House subcommittee that considered the 1976 amendments, stated on the floor of the House:

> Underwriting all of the provisions of the transfer, this legislation authorizes "certificates of value," which are financial instruments, to guarantee the creditors the net liquidation value of their assets if the new corporation fails. It is this net liquidation value that the Supreme Court in the New Haven case determined was the value of a bankrupt railroad.

121 Cong. Rec. H12754 (daily ed. Dec. 17, 1975).

would thus be impermissible, as a matter of statutory construction, to take account in fixing NLV of the possibility, probability or, as the transferors would have it, certainty that, failing the Rail Act, the United States would have been obliged to make other arrangements for continued rail service. This would be true even if we were required to take account of that factor in fixing CMV. However, as will be shown in Part IV of this opinion, we are not required or even permitted to determine CMV in this manner. Congress created the CV's to afford a bridge, partial or total, between the value of the ConRail securities and CMV—not to constitute part of a bundle that might exceed CMV, with the consequent need for corrective action by this court under § 303(c)(3).[13] *See* H.R. Rep. No. 94-725, *supra* at 90 ("[T]he Committee believes that the certificates of value will assure to each transferor consideration equal to the requirements of a constitutional minimum.").

(3) *The contention of the Government parties that, for purposes of determining NLV, potential sales to other government bodies must be disregarded*

This leads us to the renewed contention of the Government parties that in determining NLV, and for that matter CMV, potential sales to other governmental bodies may not properly be taken into account. Just as we see no reason why sales to other railroads for railroad use should be excluded from consideration in fixing NLV, as the Government parties other than DOT now concede, Brief at 72-74, we likewise see no basis for assuming that

13. Section 303(c)(3) provides in relevant part:

> If the special court finds that the terms of one or more conveyances or exchanges for securities, certificates of value or other benefits are fairer and more equitable than is required as a constitutional minimum, then it shall order the return of any excess securities, certificates of value, or compensation to the Corporation or a profitable railroad, State, or responsible person so as not to exceed the constitutional minimum standard of fairness and equity.

when Congress spoke of liquidation it meant to exclude sales to public bodies. It must have been known to Congress that there had been such sales, particularly of commuting lines, and there was every reason to suppose that in the event of such a catastrophe as a general cessation of railway service in the Northeast, states and municipalities would at least endeavor to salvage the lines on which hundreds of thousands of citizens traveled to and from work in the cities. Indeed, other sections of the Rail Act reflect Congressional recognition of the active role state and local governments would assume in ensuring continued rail service. Section 304(c)(2)(C) of the Act provides that rail service may not be discontinued if a financially responsible person "including a government entity," offers to purchase the rail properties in order to continue service. Section 403 provides for federal loans to enable state and local governments to make such purchases. *See also New Haven Inclusion Cases, supra,* 399 U.S. at 450 n.66 (citing Penn Central negotiations with Connecticut and New York for state takeover of New Haven commuter services).

Of course, if the Government parties were right in their contention that prices payable by public bodies cannot be taken into account in determining CMV, this would argue against taking the possibility of such sales into account in determining NLV, for reasons similar to those on which we partially relied in rejecting the notion that NLV could take account of a possible sale to the United States. However, for reasons developed in Part IV of this opinion, we largely reject that contention.

(4) *The method for determining scrap value*

As already indicated, although the Government parties other than DOT concede that the transferors are entitled to attempt to prove NLV based on sale of part or all of their property to profitable railroads, the only figures presented to Congress in the FSP contemplated sale for scrap in accordance with the MLP. Vol. I, at 124-26. This plan was more fully described in a report dated March 1, 1976. The report disclosed, as FSP had already

done in some degree, Vol. I, at 145-46, that one of MLP's assumptions was that a considerable amount of time after the conveyances would be consumed in obtaining regulatory approvals.[14] Recognizing that the time required in fact would unpredictably differ with the nature of the trackage, the Report assumed a uniform date of January 1, 1979 for the commencement of the winddown.[15]

At the oral argument in April, 1977, counsel for the Government parties advised the court that they no longer considered valid the assumption of a three year delay before the sale program could begin and that they were developing an alternative approach. In response to the court's request that the Government parties promptly inform it and the other parties of significant changes contemplated in MLP, the Government parties filed a statement on July 5, 1977. MLP will now eliminate any assumption that any time after April 1, 1976 would have to be spent in securing abandonment authority.[16]

14. Specifically, the Report assumed that the railroads could only commence liquidation pursuant to orderly plans that would minimize the impact on the economy, that judicial and regulatory approval of such plans would take from two to nine years, that ICC approval for trackage abandonments would take up to 10 years, and that the time required for orderly transition of services to other railroads and modes of transportation, "a critical factor affecting the willingness of the judicial and regulatory authorities to let liquidation commence," would be 7-10 years. *See* Selected Inputs to Valuation Analysis, I-1 to I-14, in *Valuation Reports of Properties Subject to the Regional Rail Reorganization Act of 1973* (1976).

15. Winddown is defined as "a period of intense activity associated with the promulgation of freight and passenger embargo notices and the preparation for ending railroad operations." *See* Master Liquidation Plan and Summary of Valuation Reports, at 7-10, in *Valuation Reports, supra.* The period lasts 90 days, followed by a 180 day period, commencing April 1, 1979, for consolidation of inventories of rolling stock, materials and supplies, and other nonfixed assets. Sales of rolling stock would begin on April 1, 1979, and sales of dismantled facilities on July 1, 1979, continuing for a considerable time thereafter.

16. This concession is due to the fact that MLP, now styled the "retrieval model," assumes the existence of the Rail Act. Since the compelled conveyances constituted a maturation of the carriers' "*Brooks Scanlon* rights," *see* 180-Day Appeals, 384 F. Supp. at 918-20; CUE opinion, pp. 27, 37, the Government parties no longer insist on

Appendix E

The parties appear to agree that most issues concerning the methodology of the MLP are not yet ripe for decision—a rather obvious conclusion since MLP is still evolving. However, the Government parties have asked us to uphold the validity of the model for purposes both of NLV and CMV insofar as it presupposes a coordinated method of withdrawal. In contrast, the transferors seemingly invite us to rule that the model is invalid on precisely this account, since the scrapping of one railroad, particularly if PC were the one, might avoid any need for scrapping others. We decline both invitations.

The Government parties stress that what they term the "retrieval model" embodied in the MLP assumes the presence of the Rail Act and apparently argue that this requires a hypothesis of simultaneous withdrawal. It is surely true that the Rail Act compelled the operation of all the roads until April 1, 1976 and the cessation on that date of operations over the mileage that was

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assuming the need for further regulatory approvals for scrapping the properties—although they continue to insist that regulatory delays after April 1, 1976 must be taken into account in any "alternative scenario" which involves sale of part or all of the properties for rail use and, if only part were so sold, for the scrapping of the rest. While it might seem that this changed assumption would substantially increase the scrap value figure, since the reports assumed a pre-tax discount rate of 13% for property other than real estate and 16% for real estate, much of the bloom is taken off the rose by the following qualification (p. 10):

> The Government Parties' conclusion that, for retrieval model purposes, the transferors must be deemed to have certificates of abandonment in hand on April 1, 1976, does not undermine the validity of the concept of using a computational proxy to model a multidate process. The validity of any particular proxy date depends, of course, upon (a) the nature of the gradual process for which the proxy substitutes, and (b) a fair valuation equivalence between the present value of the net proceeds produced by the gradual process and that produced by use of the proxy date. USRA has commissioned a study to determine an appropriate proxy date in light of the elimination of any pre-availability delay after March 31, 1976, attributable to the need for abandonment approvals, as well as possible changes in USRA's valuation of particular asset categories. Preliminary results of the study suggest that the new proxy date may be earlier than January 1, 1979.

transferred, with a consequent fulfillment of *"Brooks-Scanlon* rights" at that tie. But, as developed in our CUE opinion, p. 35, the railroads were constitutionally entitled to cease operations after a reasonable period for securing abandonment authority on applications which (save in the case of EL) would have been filed in early 1973 but for the discussions leading up to the Rail Act. Since the Rail Act foreclosed this right, each transferor must be allowed to prove, if it can, that exercise of this right, even in the form of a sale for scrap, would have yielded more than MLP.

A transferor cannot, of course, realistically assume that it would have been operating in a world where it was the only railroad engaged in a liquidation for scrap. If it presents a plan which does not appropriately allow for this, the Government parties can object on that account. By the same token, we see no reason why the Government should not be permitted to come forward with figures based on MLP, as it may be revised, since at the least this shows what one possible method of disposition for scrap would have been. What is important is that the transferors should now make known what they intend to advance as their scrap liquidation plans, so that the Government parties will know what cases they will be obliged to meet. We direct that each transferor should serve and file such a plan not later than December 9, 1977.[17] While most of the revisions of MLP have been promised by this fall, we are distressed that some (real estate valuations and a variety of other studies including the highly important subject of discount rates) will not be ready until 1978. We direct that the Government parties make every effort to expedite this work.

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17. If the transferors would prefer a course whereby they would seek to coordinate their scrap liquidation plans before disclosing them to the Government parties and the court, similar to what we later direct in connection with sales for rail use, *infra*, p. 30, we will entertain a proposal to modify the above direction accordingly. So also if the transferors should elect to forego the submission of any plans calling for a solely scrap liquidation and to integrate scrap sales with sales for railroad use.

(5) *The method for determining values attainable on sales for railroad use*

The Government parties concede (Brief at 74) that:

> Any transferor is entitled to attempt to show that it had (before the Rail Act was passed) and would have exercised (had the Rail Act not been enacted) a right to take some specific course of action to realize rail use values from its properties.

However, the Government parties insist, *id.*, that any endeavor on the part of transferors to show that such a course would have produced values exceeding the sale of their properties for scrap must conform to an "alternative scenario." They say this must meet four criteria: "(1) consistency, (2) feasibility, (3) legality, and (4) the assumed absence of the Rail Act or any other new governmental action designed to keep the rail properties indefinitely in operation." (Govt. brief at 77). Application of the last of these criteria would, in practical effect, make presentation of an alternative scenario impossible since, as appears from our CUE opinion, pp. 41, 54 nn.59 & 60, 61, many transferors claim they would have reached the point of cashlessness in early 1974 and Erie Lackawana (EL) claims it would have reached this point in the winter of 1975 absent the emergency assistance provided by the Rail Act.

At oral argument Government counsel relented in some important respects from the rigidity of the position taken in brief. The Government indicated that it would not demand proof that the transferors had received actual offers at identifiable prices. This might well be difficult to show in view of the fact that once serious discussion of what was to become the Rail Act began in the winter of 1973, profitable railroads had little incentive to conduct discussions directly with the various reorganization trustees. Hence it would be enough to show that, in the phrase used by counsel for EL at oral argument, profitable railroads should in their "own self

interest" have wished to purchase various lines of the transferors. On the point mentioned at the end of the preceding paragraph, the Government parties also conceded that an alternative scenario might legitimately assume that the Government would have provided emergency assistance in some form for a reasonable period "to permit adequate ICC review of the abandonments or transfer applications," Transcript at 296, and to avoid liquidation "in chaos," Transcript at 283. Furthermore, counsel for the Government parties did not exclude the idea that the alternative scenario could take account of possible regulatory reforms, including those made by the Railroad Revitalization and Regulatory Reform Act of 1976, which would have made purchases more attractive.

We believe these concessions were well advised; indeed they may not constitute the limit. If the Rail Act had not been passed, Congress still would have had powerful incentives to attempt to preserve at least some of the rail transportation previously furnished by the bankrupt entities in the Northeast and to make reasonable funds available to the reorganization trustees while studies were being prepared and negotiations with other railroads were proceeding; the parties will doubtless differ whether these would have been loans or grants. Although the Government parties may well be right in saying that the transferors cannot legitimately hypothesize that Congress would have done more in the way of interim financial aid to keep the bankrupt estates alive pending negotiations with other railroads than it did in the Rail Act pending the development and consummation of the FSP, the Government equally cannot sustain the proposition that Congress would simply have sat by and done nothing.

However, the Government parties have not receded from their most basic position relating to the alternative scenario, namely, the requirement of consistency. For example, they would insist, with reason, that it would be improper to fix NLV or CMV on the basis that a number of transferors would have been able to sell lines connecting the same points to a single profitable railroad

when that railroad would have wished only one, or to assume that a particular line would have substantial traffic because a parallel line was being dismantled and then to make the same assumption in valuing the parallel line. From this premise, the Government parties go on to insist (Brief at 81) that "all transferors seeking to show rail use values for particular lines should be required to set forth explicitly their underlying assumptions about all other lines whose dispositions would bear on their properties' value." As a practical matter, this would seem to require a joint presentation by all transferors proposing to offer evidence of higher values attainable by sales for rail use.

Such a course of action by the transferors would surely be desirable and, at the conclusion of the oral argument on April 13, we suggested that the transferors should not await the issuance of this opinion but should begin conversations among themselves with a view to seeing whether a unified alternative scenario could be developed and to report to us if any progress along these lines had been achieved. We have received no report as to what, if anything, has been done. While we believe that, as in the case of sales for scrap value, each transferor is entitled to make its own proffer as to what it would and could have done by way of sales for rail use, the Government parties are right in saying that a most difficult problem will be presented if transferors make basically inconsistent proposals. It is in everyone's interest that all reasonable efforts should be made to eliminate or at least to reduce these inconsistencies. We therefore direct that any transferor seeking to present evidence of values to be obtained by sales for rail use shall exchange its proposal with all other transferors not later than January 9, 1978; that the transferors shall then meet among themselves with a view to a maximum ironing out of inconsistencies; that they shall deliver their proffers, as these may be revised in the light of such discussions, to the Government parties on a date not later than March 9, 1978; that the Government parties shall indicate any objections on the score of inconsistency within another 30 days; and that finally revised proffers shall be filed

with this court not later than 30 days after the transferors' receipt of the Government's objections. We do not deem it practical at this time to specify the level of detail to be contained in such proffers, beyond saying that they should be sufficiently particularized to be meaningful.

We also agree with the Government parties that the proffers of sale for railroad use must meet the criterion of legality. In saying this, however, we would not wish to be understood as ruling that the transferors must carry the burden of showing that the proposed transactions would have been approved by the Interstate Commerce Commission under criteria which the ICC had evolved in dealing with sales of profitable railroads. The Commission would have been confronted with a situation quite unlike those with which it had been presented in previous merger cases. Just as the antitrust laws have received a different application in the case of the acquisition of a failing business, *International Shoe Co.* v. *FTC*, 280 U.S. 291, 301-02 (1930); *Citizen Publishing Co.* v. *United States*, 394 U.S. 131, 136-38 (1968); Department of Justice Merger Guidelines ¶¶ 9, 15, 21 (1968), *reprinted as amended in* 1 Trade Reg. Reptr. [CCH] ¶ 4510, the Commission would have been permitted, indeed required, to apply different criteria, particularly as to the preservation of competition within the Northeast Region and of competitive balance outside it, when it was confronted with a situation where the alternative to some sort of approval would have been the cessation of substantially all railroad operations in the Northeast. There is also the possibility that if the Commission showed signs of an undue tendency to proceed along traditional lines, Congress might have stepped in. Thus, we do not at all exclude such possibilities as joint action by the transferors in the Northeast Region or joint purchases by profitable railroads to the west and south which ordinarily might have been deemed objectionable under the antitrust laws.

Finally, we record our disagreement with the suggestion of the Government parties that the Interstate Commerce Commission

would or could have used its power to withhold approval so as to insist on the inclusion of unprofitable mileage to a degree that would have driven down the price that purchasers would pay to the level of scrap value, a view which now appears to have been the basis for the extracts from FSP, Vol. I, at 125, cited above, p. 19.[18] We do not intimate that the Commission would have had no alternatives other than complete acceptance or rejection of the proposals as made. On the other hand, the suggestion that the Commission would or legally could have required purchasers to take on more and more unprofitable mileage on the basis that no harm was being done to the transferors so long as the purchase price was no less than scrap value appears to us to be unsupported by authority[19] and in effect to negate the concession that sales for

18. We rejected an argument that was a variation on this theme in the October 18 opinion, 425 F. Supp. at 271-73.

19. In one of the cases cited, *Jamestown, W. & N. R.R. Abandonment*, 217 I.C.C. 739 (1937), the Commission refused to approve the sale of certain terminal properties to the Erie Railroad on a condition that would have required the Jamestown actually to abandon 31 miles of mainline track and thus deprive the city of Jamestown of railroad connections with three other competing carriers. When the Erie withdrew the condition, the Commission approved the sale without any effort to force the Erie to acquire and operate the track. *Erie R.R. Trustees' Purchase*, 244 I.C.C. 13 (1941). In another case, *Abandonment of Part of Line by Gulf Ports Terminal Ry.*, 111 I.C.C. 597 (1926), the ICC merely required the abandoning railroad to accept any offer by a purchaser willing to continue all the properties in rail use that would *match* the highest offer received from a buyer which planned to operate some properties and dispose of the rest for nonrail use. The Commission did not speak of a prospective buyer which would be forced to operate properties it did not wish to operate.

Cases cited by the Government parties for the general proposition that conditions may be attached to an abandonment, *ICC* v. *Railway Labor Exec. Ass'n*, 315 U.S. 373 (1942); *Reed* v. *Meserve*, 487 F.2d 646 (1 Cir. 1973), and ICC decisions specifically conditioning abandonment on the imposition of labor protective measures, *Chicago, B. & Q. R.R. Abandonment*, 257 I.C.C. 700 (1944); *Fort Dodge, D.M. & S. Ry. Abandonment*, 312 I.C.C. 708 (1963), *off'd, Humphreys* v. *United States*, 228 F. Supp. 910 (N.D. Cal. 1964); *East Carolina Ry. Abandonment*, 324 I.C.C. 506 (1964); *Missouri-Kansas-Texas R.R. Abandonment*, 328 I.C.C. 728 (1971); *Penndel Co. Abandonment*, 342 I.C.C. 570 (1973), furnish no authority for the position of the Government parties. Nor do § 5(2) of the Interstate Commerce Act, or cases

continued rail use would have been a permissible, indeed the preferred, form of liquidation.

IV. *Constitutional Minimum Value (CMV)*

The basic position of the Government parties is that CMV is the market value of rights of which the transferors were deprived by the Rail Act. These would include (1) the right to use their properties for a profit and (2) the right to sell the properties for continued rail use by others or, failing this, for scrap.[20] While conceding the existence of (1) in principle, the Government parties consider it to be largely if not wholly theoretical on the

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decided thereunder, *e.g.*, *New York Central Securities Corp.* v. *United States*, 287 U.S. 12, 28 (1932); *Thompson* v. *Texas Mex. Ry.*, 328 U.S. 134, 149-50 (1946); *Penn Central Merger Cases*, 389 U.S. 486, 495-96 (1968), furnish analogical support for the proposition that the ICC can require a prospective buyer to operate properties it did not not wish to and could not economically operate. Section 5(2) by its terms authorizes inclusion only of "another railroad" in a merger, and then only upon petition of that railroad. 49 U.S.C. § 5(2)(d). The section thus authorizes inclusion where a separate, third-party railroad seeks to participate in a merger transaction initiated by others; we have been cited no authority that, if some of the third party's lines were profitable and others were not, the Commission could insist that hopelessly unprofitable lines must continue to be operated and reduce the price payable to the third party to reflect this. Indeed, the portion of the Supreme Court's *New Haven* decision relating to the Bronx freight yards, p. 19 *supra*, indicates the contrary.

20. The presentation of the Government parties has been complicated by persistent argument on what they call "ConRail use value." The point of this is that under the Rail Act the transferors receive all the junior securities of ConRail, so that whatever earning power ConRail possesses after payment of the charges on its debt and Series A preferred stock (or payment and redemption thereof) will belong to the transferors. While this is true for the properties transferred to ConRail taken as a whole, there may be lines which could now be operated at a profit, and some which after rehabilitation might attain that state sooner than others. Furthermore, the argument has no application to properties conveyed to persons other than ConRail, for which no ConRail securities are issuable. We thus fail to see that "ConRail use value" has great significance except as a shorthand way of stating that the conveyances compelled by the Rail Act differ from those usual in condemnation in that the transferors do retain upside potential if the properties should turn out to have earning power not reflected in the value of the ConRail junior securities at the redemption date of the CV's.

submissions that have been made to date, since nearly all transferors have asserted, notably in their briefs on CUE, that their properties were hopelessly losing and were destined to remain so.[21] As already indicated in Part III, the Government parties further submit that scrap value should be determined in accordance with a Master Liquidation Plan (MLP) and insist that proposals in regard to sale for rail use should conform to a single "Alternative Scenario."

While the transferors attack the MLP and the demand for a single Alternative Scenario on the grounds indicated in Part III of this opinion and others, their major contention with respect to CMV is that the entire approach of the Government parties is wrong. Pointing to numerous declarations of members of the executive and legislative branches during the consideration of the Rail Act and to recitals in the Preliminary System Plan[22] they

21. The Government parties other than the DOT further suggest that as a practical matter any value in possible retention for rail use by a particular transferor would be reflected in value for sale to others for rail use. This is not necessarily true since while capitalized earning power would be what a seller would ask, it is not inevitably what a buyer would pay. The small number of prospective buyers, pressure on the seller to dispose of the property, and discrepancies in the information possessed by the parties to the transaction are some of the factors that would make the Government parties' "perfect market" outcome unlikely.

22. The House Committee Report on the Rail Act observed that

> The services [that the bankrupt carriers] perform are essential to the nation, and the blow to the economy if such services were interrupted only briefly, would be devastating. This is a matter which affects not only the economy, but also the defense needs of the nation.

H.R. Rep. No. 93-620, 93d Cong., 1st Sess. 28 (1973). The Senate Report was equally apocalyptic:

> [The carriers'] services are not only essential to the prosperity and well-being of the people and industry in the Northeast and Midwest, but they are essential to the well-being and prosperity of the Nation as a whole. Cessation of services on the Penn Central alone would have drastic consequences throughout the United States. For example, it has been predicted that a shutdown of the Penn Central would produce a decrease in the rate of economic activity in the region of 5.2%, a decrease in the entire

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assert that even a temporary, let alone a permanent, cessation of their operations would have caused such economic and environmental problems as to be unthinkable. They say that the value of properties which have this crucial importance to the nation but which can no longer be operated at a profit, at least in part because of national and local regulatory and promotional policies and demands, cannot be limited to what could be obtained by way of sale to private or even other public bodies. They therefore urge that, in fixing CMV, we must "consider," with what weighting is not altogether clear, many factors other than the market value of the rights of which the transferors have been deprived. These include such concepts as gross liquidation value, original cost less depreciation, trended original cost less depreciation, reproduction cost less (or even without) depreciation, assemblage value, the value of "externalities," and "societal value." In an attempt to conform these concepts more nearly to the conventional wisdom that property being condemned is generally to be valued on the basis of what a willing buyer would pay a willing seller, the reply brief of the PC Trustees envisions a bargaining process in which the buyer would begin by offering an amount equal to value for continued rail use for some properties and scrap value for others,

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Nation of 4%, and a decrease in GNP for the Nation as a whole of 2.7% after the eighth week of such a shut-down.

S. Rep. No. 93-601, 93d Cong., 1st Sess. 7-8 (1973). The Senate Report concluded that the "entire economy of the United States would suffer drastically if the railroads in the Northeast and the Midwest shut down operations." *Id.* at 8. *See also* Hearings on Northeast Rail Transportation Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess., pt. 1, at 219 (statement of Claude Brinegar, Secretary of Transportation); 621-23 (policy statement of the New England Governors' Conference); Hearings on S. 281 Before the Surface Transp. Subcomm. of the Senate Comm. on Commerce 94th Cong., 1st Sess. 1 (1975).

Section 101(a) of the Rail Act reaffirmed this determination of the essentiality of the Northeast rail system. The Preliminary System Plan, as well, recognized the "devastating implications for the regional and national economy" of shifting freight to other modes of transportation. Vol. I, at 139.

knowing that the seller would not take less, and the seller would begin by demanding reproduction cost less depreciation, knowing that the buyer would not pay more, and bargaining would then ensue.[23] This has the further effect of bringing CMV in line with NLV and thereby avoiding the need for proceedings in the Court of Claims.

Before going further it is useful to comment on what seems to us to be a difference in the concept of "property" held by the Government parties on the one hand and certain transferors on the other. Some transferors challenge the Government parties' valuation theory at a fundamental level by arguing that what was taken, and what must be valued , is "property," not "rights" to use or sell or, in a favorite phrase of the Government, "foreclosed options." If they mean by this that the Government's "foreclosed option" approach is only a valuation standard rather than a description of what was taken and that we should begin our valuation analysis on the premise that "property" rather than certain "rights" were taken,[24] our answer is that the definition of what was taken is so closely related to the valuation question that the two cannot be treated separately, *see Bonbright, Valuation of Property* 99 (1937) (hereafter *Bonbright*); if the point is that "property" is something more or different than certain legally-protected rights,[25] and for this reason alone must be valued on some basis other than by consideration of the rights of which the transferors were deprived, we must disagree. For "property" is nothing more than a collection of rights and can be valued on no other basis; talk of property as having some reified existence simply makes for confusion. *See Ackerman, Private Property and the Constitution* 26-27, 201-03 (1977), and numerous sources cited therein; 2 *Nichols, Eminent Domain* § 5.1[1], at 5-

23. A similar proposal had been presented in the Opening Brief of the NH Trustee. Brief at 59-73.

24. As the PC Trustees at one point apparently do. *See* Reply brief at 20-21.

25. *See* PC reply brief at 16-20; CNJ reply brief at 17-18; LV reply brief at 12-13.

8 to 5-10 (3d ed. 1976); Cohen, *Property and Sovereignty*, 13 *Cornell L.Q.* 8, 11-12 (1927); *cf. Bonbright* at 100-08. As Mr. Justice Roberts said for the Court in *United States* v. *General Motors Corp.*, 323 U.S. 373, 377-78 (1945), a condemnation case:

> It is conceivable that the [term "property" in the just compensation clause] was used in its vulgar and untechnical sense of the physical thing with respect to which the citizen exercises rights recognized by law. On the other hand, it may have been employed in a more accurate sense to denote the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it. In point of fact, the construction given the phrase has been the latter.

(Footnote omitted).[26] *See also United States* v. *Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 81 (1913), and *Boom Co.* v. *Patterson*, 98 U.S. 403, 408 (1878).

26. Although this was said in a case involving the taking of a portion of a lease, so that it was necessary to abandon a "vulgar and untechnical" view of property as a "physical thing" in order even to find that there had been a taking of property, the Court's analysis in *General Motors* does not become inapposite in a case where the taking involves a more concrete property interest. As Mr. Justice Holmes once noted, "Ordinarily an unqualified taking in fee by eminent domain takes all the interests and as it takes the *res* is not called upon to specify the interests that happen to exist." *A.W. Duckett & Co., Inc.* v. *United States*, 266 U.S. 149, 151 (1924). Similarly, it is not surprising that courts refer explicitly to the "bundle of rights" theory of property largely when the taking is of something less than all the rights relating to the thing itself, for it is in those cases that judges are forced to clarify basic conceptions of property. *See, e.g., Town of Bedford* v. *United States*, 23 F.2d 453, 454 (1 Cir. 1927); *United States* v. *53¼ Acres of Land*, 139 F.2d 244, 247 (2 Cir. 1943), *cert. denied*, 322 U.S. 730 (1944); *Adaman Mutual Water Co.*, v. *United States*, 278 F.2d 842, 846 (9 Cir. 1960); *United States* v. *Certain Land*, 220 F. Supp. 696, 699-700 (D. Maine 1963). *See also United States* v. *Causby*, 328 U.S. 256, 261-62 (1946), where the Court reasoned that there would be a taking of property if overflights rendered the land uninhabitable since "[t]he owner's right to possess and exploit the land—that is to say, his beneficial ownership of it—would be destroyed."

Some of the transferors argue for a constitutional minimum value in excess of what could have been obtained by sale to private entities or governmental bodies other than the United States on the basis that the United States should be included in the market, while others argue that in the peculiar circumstances of this case the ordinary willing seller-willing buyer approach is simply inappropriate.

In answering the first contention, the Government parties naturally emphasize Mr. Justice Holmes' famous aphorism in *Boston Chamber of Commerce* v. *City of Boston,* 217 U.S. 189, 195 (1910), "[T]he question is what has the owner lost not what has the taker gained." That statement alone, when read in context, does not greatly aid the Government parties since it was made in rejecting a claim that the owner of land being taken by Boston for use as a street and the owner of an easement of access could aggregate their interests so as to produce a larger value than if the city took the respective rights of each.[27] However, this was not to be the Court's last word on the subject.[28] In *McGovern* v. *New York,* 229 U.S. 363, 371-72 (1913), the New York courts had upheld the exclusion of evidence to prove the enhanced value of the land taken as part of a natural reservoir site and also the "fair and reasonable value of the Ashokan reservoir site which the city is condemning," of which the land taken was a part. In affirming, Mr. Justice Holmes said:

> It is conceded 'that the owner is not permitted to take advantage of the necessities of the condemning party,' and it would seem that it might well be that the commissioners

27. As pointed out in *Orgel, Valuation Under Eminent Domain* § 88 (2d ed. 1953) at 365 (hereafter *Orgel*), it is not clear what the relevance of the value to the taker point was in the case, since the land was worth the same to the city regardless of whether the owners' claims were aggregated.

28. We omit discussion of *United States* v. *Chandler-Dunbar Co.* *supra,* 229 U.S. 53, because of the many conflicting inferences that can be drawn from the opinion. See the discussion in *Orgel* § 88 at 365-70; *see also* Note, *Valuation of ConRail Under the Fifth Amendment,* 90 *Harv. L. Rev.* 596, 600 n.20 (1977).

> regarded it as too plain to be shaken by evidence, on the public facts, that the value of the land for a reservoir site could not come into consideration except upon the hypothesis that the City of New York could not get along without it and that its only means of acquisition was voluntary sale by owners aware of the necessity and intending to make from it the most they could. *It is just this advantage that a taking by eminent domain excludes.* (Emphasis supplied).

The italicized statement is not inconsistent with remarks in *McGovern* and other cases, *City of New York* v. *Sage,* 239 U.S. 57, 61 (1915); *Olson* v. *United States,* 292 U.S. 246, 256 (1933); *United States ex rel. TVA* v. *Powelson,* 319 U.S. 266, 275-76 (1943); *United States ex rel. TVA* v. *Powelson,* 138 F.2d 343 (4 Cir. 1943), *cert. denied,* 321 U.S. 773 (1944), upholding recognition of special suitability of the property taken for the governmental purpose if the owner had the ability to unite his land with other parcels essential to the project and the properties could have been put to the desired use without a taking by the particular condemnor.

In *United States* v. *Miller,* 317 U.S. 369, 375 (1943) (footnotes omitted), the Court made a statement having the same sweep as its earlier one in *McGovern:*

> Since the owner is to receive no more than indemnity for his loss, his award cannot be enhanced by any gain to the taker. Thus although the market value of the property is to be fixed with due consideration of all its available uses, its special value to the condemnor as distinguished from others who may or may not possess the power to condemn, must be excluded as an element of market value.

To be sure, the point covered by this statement was not in controversy. The issues were whether the owner should have "the benefit of any increment of value added to the property taken by

the action of the public authority in previously condemning adjacent lands," *id.*, to which the Court answered that he should, except for an increment "arising from the known fact that the lands probably would be condemned," *id.* at 377; and whether the lands in question "were so situated as to entitle respondents to the benefit of this increment," *id.* at 375, to which the Court answered that they were not. Still the holding that value arising solely from the prospect of condemnation must be excluded does seem to hinge on a premise that the taker must be excluded from the market.[29]

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29. An emphatic statement by a lower court to that effect in a case not dissimilar to ours is *United States* v. *Boston, Cape Cod & N.Y. Canal Co.*, 271 F. 877, 893 (1 Cir. 1921), where, in ruling out evidence of the military and naval value of the condemned canal to the United States, the court said:

> We are of the opinion that in ascertaining the market value of property taken in a condemnation proceeding the utility or availability of the property for the special purpose of the taker cannot be shown, if the taker is the only party who can use the property for that purpose. If, however, the property has a special utility or availability, not only to the taker, but to other parties who could use the property for the particular purpose intended by the taker, then this utility or availability may be shown.

See United States v. *Foster*, 131 F.2d 3, 6 (8 Cir. 1942), *cert. denied*, 318 U.S. 767 (1943) ("The value of the land taken to the party taking it is not the test but its value to the owner or the loss caused to him by its taking."): *United States* v. *Catlin*, 204 F.2d 661, 664-65 (7 Cir. 1953) (instruction that jury could not consider the government's use of the condemned land for an ordnance depot in valuing the property was proper). *See also United States* v. *46,672.96 Acres of Land*, 521 F.2d 13, 15-16 (10 Cir. 1975).

We see little relevance in *Grand River Dam Authority* v. *Grand Hydro*, 335 U.S. 359 (1948), since this was a contest between two parties both having the power of condemnation, and since the condemnation issues were decided under Oklahoma law. The Court held merely that the Federal Power Act did not prevent the state court from admitting evidence concerning the value of the property as a dam site, for which it was condemned. The Court stated explicitly, "[W]e express no opinion upon what would be the appropriate measure of value in a condemnation action brought by the United States or by one of its licensees in reliance upon rights derived under the Federal Power Act." *Id.* at 373.

The Government parties rely also on statements that the just compensation clause demands indemnification and nothing more. Thus the Court said in *United States* v. *Miller, supra,* 317 U.S. at 373:

> The owner is to be put in as good a position pecuniarily as he would have occupied if his property had not been taken.

and in *United States* v. *Reynolds,* 397 U.S. 14, 16 (1970):

> The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken.

See Bauman v. *Ross,* 167 U.S. 548, 574 (1897); *Olson* v. *United States, supra,* 292 U.S. at 255; *Westchester County Park Comm'n* v. *United States,* 143 F.2d 688, 691 (2 Cir.), *cert. denied,* 323 U.S. 726 (1944). These statements gain added meaning when they are read in conjunction with Mr. Justice Frankfurter's opinion in *Kimball Laundry Co.* v. *United States,* 338 U.S. 1, 5 (1949):

> The value compensable under the Fifth Amendment, therefore, is only that value which is capable of transfer from owner to owner and thus in exchange for some equivalent. Its measure is the amount of that equivalent.

Here, if the "property had not been taken," the transferors would have had, at least so far as now known to us, hopelessly losing railroads, on the verge of "cashlessness." *See* p. 27, *supra.* The only value "capable of transfer from owner to owner" was the value obtainable by sale to private or governmental bodies other than the United States for continued rail use or by sale as scrap. The transferors answer that the United States had even greater compulsion to buy than other governmental bodies would have had and that, if we should sustain inclusion of the latter in the market, as subsequently we broadly do, there is no reason to exclude the former.

It appears to us, however, that inclusion of the taker in the market, in the sense of here attempting to reconstruct a bargaining process between the transferors and the United States, is inconsistent with the basic principle of eminent domain. While suitability of the property for a public purpose may properly be considered, this will not affect market value unless there is a prospective buyer other than the taker. It would be incongruous if the owner of an abandoned warehouse standing in the way of a contemplated highway or runway, who is relegated to market value if the building possesses some, were allowed the benefit of a hypothetical bargain with the taker because the structure had become so dilapidated as to have no market value at all. The essence of eminent domain is not only that it enables the condemnor to acquire property which the condemnee may not wish to sell but that it allows the condemnor to do this at a cost determinable in accordance with some external standard rather than by hypothesizing a bargaining process in which the condemnor's needs are an element and there is simply no way of determining the point where the bargain would ultimately be struck. *See also* Note, *supra,* 90 *Harv. L. Rev.* at 604. To reiterate Mr. Justice Holmes' statement in *McGovern, supra,* 229 U.S. at 372, "It is just this advantage [to the condemnee] that a taking by eminent domain excludes."

Thus, the usual meaning of the Fifth Amendment's just compensation clause is that the taker must pay the market value of the property, without considering its own presence in the market. In these circumstances, that rule would value each transferred property at the higher of scrap value or its sales value to parties other than the United States.

A. *Decisions Applying Rules Other than the Market Value Rule*

The transferors respond that, however we might view the matter if it were one of first impression, the decisions discussed up to this point have been qualified by others which have established that, in a case like this, a court must consider values beyond those

attainable in the market, notably reproduction cost or some variant upon it, whether on the theory of including the condemnor as part of the market or because market value is simply not an appropriate measure of just compensation. The transferors have advanced several lines of decisions to support this argument. We shall consider each of them:

(1) *Takings of property not held for profit*

The transferors refer us to federal cases such as *United States* v. *Certain Property,* 403 F.2d 800 (2 Cir. 1968), and numerous state court opinions, *e.g., Idaho-Western Railway Co.* v. *Columbia Conference of Evangelical Lutheran Augustana Synod,* 20 Idaho 568, 119 P. 60 (1911), *County of Cook* v. *City of Chicago,* 84 Ill. App. 2d 301, 228 N.E.2d 183 (App. Ct. 1967), *City of Wichita* v. *Unified School Dist. No. 259,* 201 Kan. 110, 439 P.2d 162 (Sup. Ct. 1968), *Newton Girl Scout Council, Inc.* v. *Massachusetts Turnpike Auth.,* 335 Mass. 189, 138 N.E.2d 769 (Sup. Jud. Ct. 1956), where a condemnor has taken property such as schools, churches, or parks not held for profitable use and the courts have allowed the owner to recover a sum sufficient to enable him to replace the property. *See* 4 *Nichols, supra,* § 12.32 [3][d]; Note, *Just Compensation and the Public Condemnee,* 75 *Yale L.J.* 1053 (1966); *see also Bonbright* at 419; 1 *Orgel* § 40, at 181-85. One can find in such cases statements like that in *Idaho-Western Railway Co., supra,* 20 Idaho at 583, 119 P. at 65:

> Whenever the property is of such character that it has no market value, its value for the uses and purposes to which it is being devoted and to which it is peculiarly adaptable may be shown. . . .

There are, as well, statements that appear to support the transferors' position that "[i]n such cases just compensation is arrived at by considering reproduction costs, replacement costs and other

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measures of value designed to approximate the true worth of the condemned property." PC Lienholders' reply brief at 20-21.

Whatever literal application such statements may have and, of course, the railroads here in question did possess *some* market value—the transferors' argument misses the true thrust of these decisions. The basic principle, as the Supreme Court said in the extracts from the *Miller* and *Reynolds* opinions quoted above, is that the owner is entitled to be put in as good a position as if the taking had not occurred. This means, in situations such as those here under discussion, being provided with the funds needed to build another school or church or to create another park.[30] In *United States* v. *564.54 Acres of Land*, 506 F.2d 796, 800 (3 Cir. 1974), the court stated:

> The community entity is entitled to be made whole, and making it whole means more than forcing it to abandon its non-profit community use and accept what it could obtain in the marketplace from a profit motivated purchaser. Simply stated this method insures that sufficient damages will be awarded to finance a replacement for the condemned facility. And since the owner of a facility devoted to a non-profit, public use has a proprietary as well as a community interest in it, if the fair market value exceeds the costs of the substitute facility, such an owner should be entitled to the higher of the two measures of compensation.

See also State of California v. *United States*, 395 F.2d 261, 264-66 (9 Cir. 1968).

30. Indeed, courts have limited application of this replacement cost standard to cases where replacement by the condemnee, whether public or private, is required by law or by the continuing needs of the community. *See, e.g., United States* v. *Certain Land*, 346 F.2d 690, 695-96 (2 Cir. 1965); *United States* v. *Certain Property*, 403 F.2d 800, 803-04 (2 Cir. 1968); *United States* v. *564.54 Acres of Land*, 506 F.2d 796, 800 (3 Cir. 1974); *United States* v. *Streets, Alleys & Public Ways*, 531 F.2d 882, 885-86 (8 Cir. 1976).

Here the transferors have no desire to be put in a financial position that will enable them to build another railroad; they want to exit from the railroad business, not to enter it. As the Supreme Court said in the *Rail Act Cases, supra,* 419 U.S. at 156,

> Complainants evidence no interest in retaining their property for longer than the Rail Act requires. Indeed, their position is really that they want to be free to dispose of it sooner. Thus, there is no interest asserted in retaining the properties themselves; the *only* interest is in making sure that creditors receive fair compensation for those properties.

In short, the notion of indemnity which is the root principle of the line of decisions here being reviewed is of no avail to the transferors in this case.

(2) *Use of reproduction cost to value a plant being used for a profitable purpose but unmarketable as such*

The transferors rely on the portion of *United States* v. *Certain Property Located in the Borough of Manhattan,* 306 F.2d 439, 445-49 (Foley Square) (2 Cir. 1962), relating to the newspaper *Il Progresso* as showing that when there is no market for property, reproduction cost may be used. Apart from the fact that the court ruled against the owner, not for him, the argument ignores the point central to the court's discussion. This was that *Il Progresso,* although operating in a 84 year old building and with rather outmoded machinery, was making a profit and wished to continue going on just as it had been. *See id.,* Appendix to Brief of Defendants-Appellants, at 1114a (District Court decision). Even so, the court sustained a zero award for the building on the basis of evidence that it had no value as a loft building and the absence of evidence that it had any more value as a printing plant. Evidence of reproduction cost of the machinery less depreciation was held to have been properly admitted as one way of getting at

the amount required to indemnify *Il Progresso*—by providing the funds it would need to start a similar operation elsewhere, 306 F.2d at 449. Here, as we have just seen, the transferors advance no such theory of indemnity. Unlike *Il Progresso,* they want to discontinue their business, not to continue it at a new site.

(3) *Cases where the market value of property is temporarily distorted or eliminated by governmental action*

Another group of cases said to require a departure from market value as a criterion in this proceeding concerns situations where market value has been adversely affected by governmental activity. The transferors claim that the Government's regulatory actions and its subsidization of other competing forms of transport bring them within the thrust of these decisions. It will be useful first to review the cases and then to consider their applicability.

Some of the cases concern compensation for property whose ordinary use and marketability were affected by wartime governmental regulation. In *United States* v. *Buxton Lines, Inc.,* 165 F.2d 993 (4 Cir. 1948), the federal government requisitioned a cargo ship with the idea of converting it to a troop transport vessel but returned the ship four months later when the conversion proved impractical. Rejecting the Government's claim that only a nominal amount was owed since the owner would not have been able to sell, charter or otherwise profit from the ship under wartime market conditions, the court ruled that just compensation must be set at "the sum which would probably be arrived at as the result of fair negotiations between an owner willing to sell and a purchaser willing to buy after due consideration of the elements affecting market value," adding that "[t]he purchaser willing to buy may be merely a hypothetical figure . . . as long as his absence is not attributable to the fact that the property has no value." *Id.* at 996. However, this holding was rested on the special fact that

> the [ship] could quite easily have been used during the period in question, the only difficulty being the absence of a private market as a consequence of the war and Government policies.

Id. Specifically, the condemnee offered evidence that the Government had prevented it from accepting a foreign company's lucrative offer to purchase the ship. *Id.* at 997. *Buxton* holds little more than that the Government cannot by order destroy a market, with buyers who would have been willing to pay high, perhaps even exorbitant, prices, and then say the property is worth nothing.

Swiss Federal Railways v. *United States,* 112 F. Supp. 357 (Ct. Cl. 1953), is a parallel case. The Court of Claims there rejected the Government's contention that just compensation for certain rail tires designed for use on Swiss track was scrap value in light of the absence of any other market at the time of taking in 1943. Although in fact it was the British blockade of shipments to Europe that prevented the tires from leaving New York, the court characterized the issue as if the United States' wartime regulation was responsible for the condemnee's inability to use or dispose of the tires. *See id.* at 361:

> Would anyone contend that the Government could take the completed or partially completed works of a fine watch that was ready to be fitted into the case and, on account of wartime conditions, forbid the sale of watches and pay for the watch on the basis of the limited value of the raw material that went into its production? Would anyone dare suggest that the Government could take a man's house and by forbidding the sale of houses or limiting the sale hold the value to the scrap value of the material that originally went into the house? If this were carried to its ultimate result the Government could requisition the arms and ammunition, the trucks and cars used in wartime, and pay for them on the basis of scrap material. It could make

> a regulation forbidding the sale of these articles in the general market and limit their sale to the Government itself. No one would even dare suggest that it would satisfy the requirements of the Fifth Amendment to offer to pay for them on the basis of scrap material. Yet that is the ultimate effect of what is being contended for in the instant case.

Considering several factors,[31] the court found a value of $4,000, although it had noted that the ceiling prices set by the Office of Price Administration would yield $8,100.84 on the domestic market and $9,180.95 on the export market and that "[t]his would undoubtedly be the rate of compensation had there been a market for these tires," *id.* at 359. The award, apparently, was the value of the tires to the condemnee for its own use, *see id.* at 361, 362. *See also Wilson Athletic Goods Mfg. Co.* v. *United States,* 161 F.2d 915 (7 Cir. 1947), rejecting the government's scrap valuation for certain processed aluminum sporting goods and considering instead "all factors existing at the time of the seizure," *id.* 917, where an order of the War Production Board had "destroyed the ordinary market for aluminum," *id.*, and stating that the property taken "could have been held by plaintiff and later used for the purposes for which it had been fabricated," *id.* at 918; *Illinois Pure Aluminum Co.* v. *United States.* 67 F. Supp. 955 (Ct. Cl. 1946), *cert. denied,* 330 U.S. 834 (1947), where the court also considered "all the facts and evidence," *id.* at 958, in fixing just compensation for aluminum requisitioned after orders of the War

31. Specifically, 112 F. Supp. at 362:

> the fact that the value of the tires as manufactured articles was far above the price of scrap, the fact that they were purchased for a specific use and not for a speculative purpose, . . . the wartime conditions that existed, the necessity for special allocations and priorities, the natural and proper restrictions that are placed around the disposition of materials in a period when the world is torn by war, and . . . the various regulations and restrictions and limitations that were placed upon articles of this character and made of this material. . . .

Production Board that were said to have "limited the use of aluminum, finally throwing a curtain of steel around its disposition so that its use was practically limited to war purposes," although noting that "we do not think plaintiff can justly claim a value that would have prevailed had no wartime regulations or controls existed or been necessary," *id.* at 956; and *Seven-Up Bottling Co. of Los Angeles, Inc.* v. *United States,* 68 F. Supp. 735 (Ct. Cl. 1946), *cert. denied,* 332 U.S. 757 (1947), where the restrictions the Government placed on the use of waters after Pearl Harbor destroyed the market for yachts, and the court in compensating the owner of the requisitioned vessel took into consideration "the conditions that prevailed and the intrinsic value of the vessel," *id.* at 736, including depreciation and the cost of maintenance while the vessel was in lay-up status.

In two other cases, the Government's pre-taking activity affecting market value related peculiarly to the property taken. In the first case, *Turney* v. *United States,* 115 F. Supp. 457 (Ct. Cl. 1953), the court was presented with the task of valuing certain classified radar equipment that had mistakenly fallen into private hands in the Philippines as part of a sale of government surplus. After negotiations for return of the equipment stalled, the Federal Government arranged for an embargo of the property by the Philippine government in contemplation of its repossession. Emphasizing the Federal Government's role in preventing any sale—the owners had commenced negotiations with the Chinese Nationalist Air Force—the court set an award of $75,000, although the Government's procurement cost was $441,889.79 and the Government in selling similar property as surplus sought $36,825 or $7,365.50 (depending on the appropriate classification). *See* 115 F. Supp. at 464-65.

In the second case, *United States* v. *220.0 Acres of Land (Assateague Island Condemnation Case),* 324 F. Supp. 1170 (D. Md. 1971), the United States condemned Assateague Island for preservation as a National Seashore. The Government sought valuation based on sales of lots in certain parts of the island in

past years while the owners claimed "that prices during those years were depressed by special and unusual circumstances, including actions taken by the State of Maryland at the instance of the Secretary of the Interior." *Id.* at 1172 (footnote omitted). After setting out in detail the activities of the federal and state governments in discouraging the private development of the island, the court ruled that such depressed market values could not be dispositive of just compensation. *See id.* at 1180:

> The principal legal problem in this case is the effect that should be given to the actions of the State of Maryland, which were induced to a considerable extent by the Secretary of the Interior, and were intended to prevent any building on Assateague during the years 1963-1965. . . .
>
> The Court concludes that in the context of the present case the consequences of those actions should not be ignored or dismissed as "incidents of ownership." It would be unfair to permit the condemning agency to depress property values, directly or indirectly, by interfering with the property owners' rights to use their land, and then take advantage of such depression to reduce the price which it must pay for the property.

In sum, the cases hold that the Government may not manipulate a market to depress prices and then benefit from the reduction.

In an effort to bring themselves within these cases, the transferors have mounted an extensive presentation to show that public policies toward the railroads have had such a depressing effect as to entitle them to a valuation on the basis of a market somehow reconstructed so as to be free from these adverse effects or on some other basis that would more properly reflect the "intrinsic" value of their properties. A particularly impressive showing with respect to such public policies was made in the opening brief of

Intervening Penn Central Lienholders. Citing a long list of governmental publications,[32] this analysis divided the detrimental public policies into two general categories:

First,

> Public (federal, state and local) financial subsidies to the intermodal competition of the railroads which decisively favored rival modes and hurt the railroads at precisely the time that such a competitive disadvantage was most likely to jeopardize the survival of the railroad. . . .

And second,

> A regime of regulatory and political constraints governing the railroads that stifled efforts to respond to larger economic forces impacting the railroads and to the specific challenges of less regulated intermodal competition; all evidenced by artificial and destructive policies on such subjects as rates, divisions, technological and service innovations, labor relations, service and branch line curtailment, to name just a few.

(Brief at 96-97).

In support of the former, the brief quotes from the Preliminary System Plan

32. Staff of the Senate Comm. on Commerce, 92d Cong., 2d Sess., The American Railroads: Posture, Problems and Prospects (Comm. Print 1972); Staff of Senate Comm. on Commerce, 92d Cong., 2d Sess., The Penn Central and Other Railroads (Comm. Print 1972); U.S. Dept. of Transportation, Northeastern Railroad Problem (1973); USRA, Final System Plan (1975); USRA, Preliminary System Plan (1975); U.S. Department of Transportation, Rail Service in the Midwest and Northeast Region (1974); Rail Services Planning Office of I.C.C., Evaluation of the U.S. Railway Association's Preliminary System Plan (1975); I.C.C., Means for Preserving and Maintaining Essential Rail Services, Report Pursuant to S.J. Res. 59 (1973); Task Force on Railroad Productivity of The National Commission on Productivity and The Council of Economic Advisers, Improving Railroad Productivity (1973).

Appendix E

> The early assistance to railroads pales when compared to the continuing aid given to the development of the private automobile and trucking industry, the airlines and inland barge operations—all competitors to the railroads.
>
> Through 1973, total federal, state, and local expenditures to support rival forms of transportation have been in excess of $450 billion, most of it spent since 1920.

PSP, Vol. I, at 4.

Federal, state and local government expenditures for highways between 1951 and 1973 amounted to almost $305 billion and for waterways to almost $14 billion. At the same time the railroads were able to invest only about $37.5 billion, all internally generated or privately raised. Moreover, whereas the highways and waterways are free from state and local taxes, these consumed more than half of the pre-federal income tax net railway operating income of the Class I railroads for many years until by 1970 they exceeded such income. The railroads were burdened with the capital costs of providing and maintaining their rights of way whereas their motor and water competitors were not. The railroads were also burdened by regulation, particularly by use of the minimum rate power to prevent their competing more effectively with motor and water carriers. The PSP, Vol. I at 4, cited a recent study which estimated the enormous loss from excess capacity and misallocation of resources attributable to regulatory inadequacies as ranging from $4 to $9 billion annually. *See also* Friedlaender, *The Social Costs of Regulating the Railroads, 61 Papers and Proceedings of the American Economic Assoc.* 226, 234 (1971) (estimating $2.4-3.8 billion loss in 1969). The brief lists various defects and inadequacies in rate regulation, prohibition of diversification into other modes of transportation, failure to increase the divisions of the railroads in the northeastern region, refusals to allow the railroads to terminate light density lines and losing passenger service, and what is claimed to be unduly favorable treatment of job protection for railroad labor, as

instanced, for example, by Senate Joint Resolution 59 of February 9, 1973, Pub. L. 93-5, 87 Stat. 5, noted in our CUE opinion, p. 14, which thwarted the efforts of the PC Trustees to reduce the size of train crew consists.[33]

While answers can doubtless be made to some of this barrage of charges, we have little doubt that the governmental policies and actions we have here summarized and others we have omitted in the interest of brevity have contributed greatly to the plight of the northeastern railroads. Not denying this, the Government parties assert that such matters may not be taken into account in fixing "just compensation" unless the governments' acts were unconstitutional, which the transferors other than Reading, *see* fn. 35 *infra*, have not claimed.

The decisions discussed up to this point do not support the broad conclusion the transferors would have us draw from them. *Buxton Lines, Swiss Federal Railways, Wilson Athletic Goods, Illinois Pure Aluminum,* and *Seven-Up Bottling* were concerned with distortion of market conditions related to wartime governmental needs or exigencies, not to governmental activity serving more traditional regulatory or promotional purposes. The courts have deemed it somewhat unfair to ignore market values that will be shortly attainable—and indeed would have been attainable during the war if the Government had not prevented their realization.[34] Furthermore, when an industry has not been directly

33. For a thorough review of Federal regulatory and tax policies regarding the railroads and other forms of transportation, see Study of Federal Aid to Rail Transportation: Report of the Secretary of Transportation to the United States Congress Pursuant to Section 902 of the Railroad Revitalization and Regulatory Reform Act of 1976 (1977), especially chapters III, IV and V.

34. These cases may thus be thought to be akin to those that would disregard fluctuations owing to periods of depression or boom markets—a situation where the decisions are said to go both ways. *See* 4 *Nichols, supra* § 12.3112; 1 *Orgel* §§ 24-25. *See also United States* v. *Cors,* 337 U.S. 325, 333-34 (1949), indicating that an increase even in private market price attributable to the Government's wartime needs is not compensable. It should also be noted that the Supreme Court in *United States* v. *Commodities Trading Corp.,* 339 U.S. 121, 125-29 (1950), disapproved compensation for so-called "retention value"—the

regulated but is affected incidentally by temporary regulation designed towards another end, the investors may well not have taken the prospect of government action into account. In contrast when an industry has long been the subject of direct and permanent regulation, governmental action is taken into account by those investing in it. Regulation has been a fact of life in the railroad industry for a century, and government assistance in the building of roads, canals—and later the railroads themselves—goes back to the early days of the Republic. If a state chose to condemn a toll road, the owners of the latter could not successfully claim that it must be valued on a basis that would ignore the competition from free roads the state had built. *Turney* and *Assateague Island* are even further removed from this case as in both the inadequacy of the market was caused by the taker's actions which had the direct effect of reducing the market value of the specific property that was shortly to be taken.

A decision closer to supporting the transferors' position is that of a badly split New York Court of Appeals in *In re Fifth Ave. Coach Lines, Inc.*, 18 N.Y.2d 212, 273 N.Y.S.2d 52 (1966), *appeal dismissed*, 386 U.S. 788 (1967). The majority of four there held that a condemnation award of "going concern" value to a formerly profitable bus line which had lost its earning capacity was required when the loss of earning capacity was not due to "the economic law of diminishing returns or inefficient management"

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value of the right to hold on to property until a value-reducing governmental regulatory scheme (in that case, Office of Price Administration ceiling prices on pepper) came to an end and then to dispose of it—a result that would call into question the result in the cases here under discussion to the extent that they reflect the notion that the property should be valued at greater than a depressed market value because of such a "retention value." *See Swiss Federal Rys., supra*, 112 F. Supp. at 360 (attempting to distinguish *Commodities Trading Corp.*) 4 *Nichols, supra* § 12.3111, at 12-131 n.6 (suggesting that *Swiss Federal Rys.* "implicitly recognized" the "retention value" rejected by *Commodities Trading Corp.*). *See also United States* v. *Felin & Co.*, 334 U.S. 624 (1948) (upholding award based on OPA ceiling prices for commodities).

but occurred because New York City, which was both the condemnor and the ratemaking authority, had denied "for political reasons, the right to charge an increased and reasonable fare" that would have yielded "large gains in gross revenues and greater gains in net profits as going concerns at the time of condemnation." *Id.* at 220-21, 273 N.Y.S.2d at 56.

We basically disagree with the *Fifth Avenue Coach* majority. Railroads, like other forms of business, take their chances on what government may do in the way of regulating them or helping their competitors. So long as government has not acted beyond its constitutional powers, a condemnee is not entitled to the recognition of values that have been impaired by a long and established course of government action.[35] Two judges joined Judge Keating in a dissent saying that:

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35. We expressly reject the claim of the Trustee of the Reading that "regulatory strangulation" and particularly approval of the Penn Central merger constituted a taking. In regard to the merger, as pointed out in our CUE opinion, p. 52, and in *Erie-Lackawanna R.R.* v. *United States,* 279 F. Supp. 316, 330-32 (S.D.N.Y. 1967), *modified and aff'd Penn Central Merger and N & W Inclusion Cases,* 389 U.S. 486, 519-20 (1968), Reading had ample opportunities to protect itself both in the B & O—C & O and in the Penn Central merger proceedings but neglected to avail itself of them until too late. *See also* Brief of Reading Co. at 56-57. The Reading also offered no timely challenges to the other regulations it now assails as unconstitutional. The argument that *United States* v. *Dickinson,* 331 U.S. 745, 749 (1947), entitled the Reading to delay bringing suit for 70 years after it claims the "regulatory strangulation" began, and nine years after consummation of the Penn Central merger stretches that case beyond reason. In *Dickinson,* the Court held that since the rising of the water level after construction of a dam was continuous, the statute of limitations did not begin to run until a final account of the damages could be struck. In *Klein* v. *United States,* 152 Ct. Cl. 221, *cert. denied,* 366 U.S. 936 (1961), where there were regular airplane flights over plaintiffs' property and in *Gregory* v. *City of New York,* 346 F. Supp. 140 (1972), where the plaintiff alleged a continuing trespass because of the city's diversion of a river in which he had riparian rights, the courts followed *Dickinson.* Here, by contrast, the regulatory actions described by Reading were a series of discrete events offering numerous opportunities for objection.

Even if Reading's claim of a regulatory taking were valid, it would not alter the standard to be applied in the determination of CMV, but would give rise to a claim for compensation independent of the one pressed in

> Political considerations, in this case the pocketbook of the millions of New Yorkers who use the transit system daily, are not to be shrugged off lightly. This was a fact of life with which the claimants were required to contend throughout their operating existence. The announcement of condemnation did not herald an end to their burden—at least it should not with regard to valuation. . . .

Moreover, even if we agreed with the majority in *Fifth Avenue Coach*, it would not bridge the gap between the cases discussed at the beginning of this section and the result that the transferors wish us to reach. Whereas in *Fifth Avenue Coach* a court could quantify the result of rate increases that had been sought and denied, no one could possibly determine what the bankrupt railroads would have earned if government had not taken, or had taken less of, the various promotional and regulatory steps of which the transferors complain.

(4) *The patent cases*

The line of decisions most helpful to the transferors' contention that value to the taker must be considered in some circumstances are cases, arising under 28 U.S.C. § 1498(a), where the Government has infringed a patent having no or little commercial use and the Court of Claims has considered the value to the Government—in some instances hypothesizing a bargaining process such as we have described above. The principal cases relied on by the transferors are *Olsson* v. *United States*, 25 F. Supp. 495 (Ct. Cl. 1938), *cert. denied*, 307 U.S. 621 (1939); *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *rev'd in part on other grounds*, 320 U.S. 1 (1943); *Badowski* v. *United States*, 278 F.2d 934 (Ct. Cl. 1960); *Saulnier* v. *United States*, 314 F.2d 950 (Ct. Cl. 1963); *Ushakoff* v. *United States*, 375 F.2d 822 (Ct. Cl. 1967); *Amerace Esna Corp.* v. *United States*, 462 F.2d 1377

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this Court, a claim for which we would not have the power to order relief.

(Ct. Cl. 1972); and *Tektronix, Inc.* v. *United States*, 522 F.2d 343 (Ct. Cl. 1977).

The most recent case, *Tektronix*, applied a willing buyer-willing seller approach to an instance where the patent had commercial value, but where the court deemed there was no established royalty rate. *Olsson*, the case most helpful to the transferors, applied a similar approach to a patent on howitzer recoil mechanisms which had no commercial value, and used cost-savings to the Government as a basis for determining a reasonable royalty. In *Ushakoff*, where the patent on solar-powered water stills again had no commercial value, the court set a rate of slightly under 5 percent, apparently based on customary commercial standards. In *Badowski*, there was a limited commercial market for the patented parachute release device; the willing buyer-willing seller approach was used by taking the prior commercial license rate as a benchmark, and then reducing the royalty somewhat because of the greater volume purchased by the Government. In *Saulnier*, the patented airplane canopy had no established commercial royalty rate and the court used the patent owner's settlement of an earlier claim against the British Government as a guide. In *Marconi Wireless*, there was no assertion that the patented radio circuitry had value only in Governmental uses; the case applies a percentage-of-cost-savings approach to establish reasonable compensation—apparently because the finished radios sold by an infringer to the Government embodied several different patents and it was thus difficult to determine a gross sales figure to which a royalty should be applied. In *Amerace Esna*, there were no industrial licensing agreements to serve as a standard for the patented process of removing rust from ballast tanks, but it does not seem very plausible that the invention was without any commercial application. The court rejected a cost-savings approach as lacking factual support and instead resorted again to the fiction of a willing buyer and willing seller agreeing on the apparently common 5 percent royalty.

Apart from the facts that the Court of Claims' application of the willing buyer-willing seller approach to the Government in these cases has never been passed upon by the Supreme Court and that the benefits realized by the patentees from that approach have been rather modest, we do not believe the cases support the broad conclusions the transferors would have us draw from them. They are distinguishable on several grounds. One lies in the origins of 28 U.S.C § 1498(a), under which these cases were decided.

28 U.S.C. § 1498(a) provides in pertinent part:

> Whenever an invention described in and covered by a patent of the United States is used or manufactured by or for the United States without license of the owner thereof or lawful right to use or manufacture the same, the owner's remedy shall be by action against the United States in the Court of Claims for the recovery of his reasonable and entire compensation for such use and manufacture.
>
> For the purposes of this section, the use or manufacture of an invention described in and covered by a patent of the United States by a contractor, a subcontractor, or any person, firm, or corporation for the Government and with the authorization or consent of the Government, shall be construed as use or manufacture for the United States.

The statute is derived from the Act of June 25, 1910, c. 423, 36 Stat. 851, as amended by the Act of July 1, 1918, c. 114, 40 Stat. 705. The 1910 statute provided in pertinent part:

> That whenever an invention described in and covered by a patent of the United States shall hereafter be used by the United States without license of the owner thereof or lawful right to use the same, such owner may recover reasonable compensation for such use by suit in the Court of Claims . . . .

The 1918 amendment changed the standard of compensation from "reasonable compensation" to "reasonable and entire compensation," and made recovery available not only when the United States had "used" an invention covered by a patent, but whenever the invention had been "used *or manufactured* by *or for* the United States."[36]

Before 1910, the protections afforded a patentee against the Government's use of his patent were strangely limited, even though it was clear that governmental use was one of the exclusive proprietary rights belonging to the patentee, *see Schillinger* v. *United States*, 24 Ct. Cl. 278, 296 (1889), *aff'd*, 155 U.S. 163 (1894); *William Cramp & Sons Ship Building Co.* v. *International Curtis Marine Turbine Co.*, 246 U.S. 28, 39-40 (1918). If a governmental officer acting within the scope of his authority and acknowledging the validity of the patent made use of the patent *with the owner's permission*, either express or implied, the United States was considered liable to a contract action in the Court of Claims for reasonable compensation.[37] *See e.g., William Cramp & Sons Ship Building, supra*, 246 U.S. at 40. *See also United States* v. *Société Anonyme Des Anciens Etablissements Cail*, 224 U.S. 309 (1912); *McKeever* v. *United States*, 14 Ct. Cl. 396, 422-24 (1878), *aff'd* 18 Ct. Cl. 757 (Sup. Ct. 1882); *Schillinger* v. *United States, supra*, 24 Ct. Cl. at 298. Such an action could be brought even though the amount of compensation had not been agreed upon, so long as the parties' mutual consent to the use of the patent could be implied, *see United States* v. *Berdan Fire-Arms Manufacturing Co.*, 156 U.S. 552, 569

36. In 1960, a section covering copyrights and paralleling old § 1498's provisions for patents was added as § 1498(b), *see* Act of September 8, 1960, Pub. L. 86-726, §§ 1, 4, 74 Stat. 855, 856.

37. The first act providing jurisdiction in the Court of Claims for claims founded upon "any contract, express or implied, with the government of the United States" was the Act of February 24, 1855, c. 122, 10 Stat. 612; that provision was later incorporated into the Tucker Act, Act of March 3, 1887, c. 359, 24 Stat. 505, now codified as 28 U.S.C. § 1491. *See Hart & Wechsler, The Federal Courts and the Federal System* 1326-27 (2d ed. 1973).

(1895). However, where the Government officer did not have prior knowledge of or disputed the patent right or where the owner had not manifested consent, the existence of a contract could not be implied and the only redress of the patentee was an action in tort against the individual official. *See William Cramp & Sons Ship Building, supra,* 246 U.S. at 40-41. *See also Crozier* v. *Fried, Krupp Aktiengesellschaft,* 224 U.S. 290, 302-04 (1912); *Interdent Corp.* v. *United States,* 488 F.2d 1011, 1013 (Ct. Cl. 1973).

The objective of the 1910 statute thus was to place the patentee who had not consented, either because the Government had not sought his consent or because it had been impossible to reach an agreement, on the same footing as the patentee who could spell out some form of consent and sue on an implied contract. In working out what the terms of such an implied contract would have been in situations where no other standards were available, the Court of Claims would necessarily have had to consider what agreement the patentee and the Government would have reached. It is thus not surprising that, despite the many references by the Courts of Claims and some by the Supreme Court to § 1498 and its predecessor as being an eminent domain statute,[38] the purpose of the 1910 statute to equate the non-consensual with the consensual transaction has properly, if perhaps not always consciously, entered into the manner in which just compensation is determined.

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38. *See, e.g., Crozier* v. *Fried, Krupp, supra,* 224 U.S. at 304-05; *William Cramp & Sons Shipbuilding Co.* v. *International Curtis Marine Turbine, supra,* 246 U.S. at 42; *Irving Air Chute Co.* v. *United States,* 93 F. Supp. 633, 635 (Ct. Cl. 1950); *Interdent Corp.* v. *United States, supra,* 488 F.2d at 1013; *Tektronix, Inc.* v. *United States, supra,* 552 F.2d at 346-47.

Although the Court of Claims has stated that § 1498 is "unrelated to contract doctrine," *Interdent Corp.* v. *United States, supra,* 488 F.2d at 1013, the court was merely holding that amendment of § 1491 to extend the court's jurisdiction to contracts and implied contracts of military exchanges did not authorize the court similarly to extend § 1498. The holding that § 1498 is not meant to govern contractual relationships is entirely consistent with the views we have expressed above.

A further basis of distinction—perhaps only a different way of stating the same one—is this. In the cases relied upon by the transferors, the Government was not taking the patent but rather a non-exclusive license for governmental use. As noted in a somewhat different context, *Schillinger* v. *United States, supra,* 24 Ct. Cl. at 298-99,

> There may be a distinction between the taking of intangible property, such as a patent right, and the taking of tangible property in this, that by the Government's use of a patent right the owner loses nothing *per se* through the taking; whereas if a tangible article be appropriated the owner instantly becomes so much the poorer . . . . [T]he use of a patented process or article may directly deprive the owner of nothing of intrinsic value, but be simply an invasion of a right . . . .

The value of which the patentee is deprived by the Government's taking a nonexclusive license is the value he might have obtained by *selling* a license or the finished patented product to the Government itself. This is true of *every* case where the Government infringes a patent, even where the patent has significant commercial value, so long as the governmental use of the patented invention does not diminish the market demand for the patent for nongovernmental uses. It should therefore be no surprise that in the instances where there happens to be no or little nongovernmental use, the Court of Claims should have sought to construct a market. Yet even in such cases the Court of Claims does not generally apply a value to the taker concept in the sense of giving significant weight to the Government's necessities. The Court of Claims has not used governmental cost-savings as even a basis of calculation under § 1498 since the *Marconi* case in 1943, *see Amerace Esna, supra,* 462 F.2d at 1379-80 & n.4, and *Tektronix* v. *United States, supra,* 552 F.2d at 347-48 & n.5, and has rejected cost-savings calculations when they resulted in royalties

which were unusually high by commercial standards, *see Ushakoff* v. *United States, supra,* 375 F.2d at 825.

Finally, while we find little merit in the broad contention of the Government parties that the results of the cited cases were dictated by the very existence of a patent system which is designed to encourage inventors by offering them suitable rewards, a narrower form of the argument has validity. This is that since adoption of the predecessor of 28 U.S.C. § 1498(a) in 1910, the Government has held out the promise to inventors that if it used their inventions without their consent, it would pay suitable compensation. Many inventors may have proceeded in reliance on this representation. To read the statute as denying compensation in cases where the invention was of no or little use save for governmental purposes would indeed keep the word of promise to the ear but break it to the hope. Congress held out no similar invitation in the Rail Act—a statute designed to preserve a failing transportation system from completely disappearing, at the minimum cost to the taxpayers permitted by the just compensation clause, and there is no suggestion that any transferor has constructed its railroad in the expectation that the Government would take it over.[39]

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39. *Armstrong* v. *United States,* 287 F.2d 577 (Ct. Cl. 1961), is somewhat similar to the patent cases. There, the Government had terminated a contract for construction of 11 boats and acquired possession of them and construction materials before 10 of the boats were complete. The plaintiffs had a materialmen's lien on this property, and the Supreme Court held that there had been a taking of their property interests for which compensation was required. *Armstrong* v. *United States,* 364 U.S. 40 (1960). On remand in the Court of Claims, the Government claimed that its prior lien for progress payments exceeded the value of the ships, so that the plaintiffs' lien was valueless.

The Court found that the ships had little or no market value because of their specialized construction and because "there was not a great market for unfinished boats any more than there would be a general market for a suit of clothes with just one leg of the trousers finished, even though the remaining material were furnished with the partially finished suit of clothes." *Id.* at 580. In determining the value of the plaintiffs' materialmen's lien, the Court therefore sought to determine the "actual and intrinsic value of the ships," considering the amount the Navy had

(5) *Condemnation of unprofitable public utilities for continued use*

The transferors cite a number of cases where the condemnor of unprofitable public utilities for continued use as such was required to pay more than liquidation value which in those instances seems to have been a sale as scrap. If we leave for further discussion the decision of the New York Court of Appeals in *In re Port Authority Trans-Hudson Corp. (PATH)*, 20 N.Y.2d 457, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968), five of the cases awarded original cost (OC), original cost less depreciation (OCLD) or an amount between OCLD and scrap value; four awarded reproduction cost new less depreciation (RCNLD). The cases which give some or controlling weight to OC or OCLD are *In re Fair Oaks Irrigation District*, [1918C] P.U.R. 879 (Cal. Railroad Comm'n 1918); *In re City of Eureka*, 19 Cal. R.C.D. 952 (1921); *In re City of Oroville*, [1922 E] P.U.R. 451 (Cal. Railroad Comm'n 1922); *In re Aldercroft Heights County Water District*, 60 P.U.R.3d 227 (Cal. Public Utils. Comm'n 1965); and *In re City of Washburn*, [1924 D] P.U.R. 368 (Wis. Railroad Comm'n 1924). The cases giving controlling weight to RCNLD are *Appleton Waterworks Co.* v. *Railroad Comm'n of Wisconsin*, 154 Wis. 121, 142 N.W. 476 (Sup. Ct. 1913); *Lanneau* v. *Capital Transportation Corp.*, 292 So.2d 810 (La. Court of Appeals 1974); *In re Ottawa and Gloucester Road Co. and County of Carleton*, 69 D.L.R. 486 (Ontario Sup. Ct. App. Div. 1921); and *International Railway Co.* v. *Niagara Parks Comm'n* [1937] 3 D.L.R. 305 (Privy Council).

We can pretermit discussion of the cases giving weight to OC or OCLD since this subject will arise in our discussion of *PATH*.

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contracted to pay for them, and the amount the shipbuilder had expended.

The case is not analogous to this one. The ships were built at the request of the Government and were only useful for the Government's purposes.

The RCNLD cases are distinguishable on their facts. In the *Appleton Waterworks* case, one of only two rendered by courts in the United States, it is not clear that the utility was incapable of profitable operation; the condemnation by the city seems to have been caused by the utility's inability to improve the service rather than by the impossibility of going on.[40] In *Lanneau*, the other case decided by a United States court, the city's own appraiser had used a RCNLD approach and the court endorsed his valuation, rejecting the plea of the losing utility for the addition of "going concern" value.[41] The *Ottawa and Gloucester Road Company* decision may have been affected by the existence of other "public bodies which might have taken over the roads, if the county had not done so," 69 D.L.R. at 489-90 (opinion of the trial court). In the *International Railways* case the Privy Council was construing an agreement that at the end of the franchise the railway should be "duly compensated for their railways, equipment, machinery and other works. . . ." 3 D.L.R. at 308. The Judicial Committee was influenced by the point that "[T]he meaning of the agreement must be the same whether the railway proved a success or a failure" and that since in the former event the Park Commission would not have been required to compensate for loss of future profits, it would be unfair to allow the

40. Upon application of the city, the railroad commission in May 1910 ordered the utility to make improvements in its plant before rate increases would be granted. Three months later, the city called an election to determine whether it should purchase the plant.

Although the utility was in receivership and a mortgage on its property had been foreclosed, there was evidence that expenditure of "at least $50,000" would render the plant "reasonably efficient," 154 Wis. at 149, 142 N.W. at 485, and no indication that there was any difficulty in meeting operating expenses. Indeed, the court's statement that in valuing the enterprise, it could not add together the value of specific items but had to determine "as accurately as possible the revenue producing power of the entirety on the basis of reasonable charges for service to customers," 154 Wis. at 144, 142 N.W. at 483, indicates that the court itself did not consider the utility to be truly unprofitable.

41. The court also noted than although the parties "to some extent" treated the litigation as an "expropriation proceeding," it was in fact merely a suit on a contract. 292 So.2d at 816.

Commission to pay only "break-up value" when the operation had become a losing one. *Id.* at 315. Moreover, the RCNLD decisions are rather dated and came from a period when reproduction cost enjoyed a greater favor than it now does (see the discussion below), and none explicitly considered the just compensation clause of the Fifth Amendment.

Despite this, the Government parties have not met the challenge of the transferors to produce a single decision in which a losing public utility being taken for continued use was valued as scrap[42] and the opinions convey a sense that such a solution would

42. The *New Haven Inclusion Cases, supra,* 399 U.S. 392, do not qualify for this role, as the Government parties urge. The New Haven was not a condemnation case, and the Court held only that an agreement between the New Haven reorganization trustees and Penn Central to sell the New Haven's assets on the basis of their liquidation value was, under the circumstances, "fair and equitable" within § 5(2) of the Interstate Commerce Act. The Court rejected the New Haven bondholders' claim to superimpose "going concern" value on liquidation value. *Id.* at 481-82. No one had argued, however, that the entire valuation should have been on a different basis, such as OCLD or RCNLD.

Market Street Railway Co. v. *Railroad Comm'n of California,* 324 U.S. 548, 564-68 (1945), comes closer to meeting the transferors' challenge. The Court there held it was not a denial of due process for a state to fix rates for a hopelessly losing street railway that would produce a fair return on the price of $7,950,000 at which the properties had been offered to the City of San Francisco, as against much higher figures of reproduction cost, book value and outstanding securities issued with the approval of the regulatory commission. Mr. Justice Jackson said, 324 U.S. at 567:

> The owners of a property dedicated to the public service cannot be said to suffer injury if a rate is fixed for an experimental period, which probably will produce a fair return on the present fair value of their property. If it has lost all value except salvage, they suffer no loss if they earn a return on salvage value. If the property has no prospect of salvage except through dismantling and sale for scrap, the scrap value for such of it as is to be scrapped may represent its present worth.

The record in the *Market Street* case does not disclose what the scrap value would have been. The transferors also urge that the quoted remarks were dicta as the Court had found that the rates that were upheld produced "all that the company could earn," 324 U.S. at 566, since any higher rates would have driven traffic away.

be unacceptable, at least if scrap value were negligible.[43] That is the rationale—the Government parties say lack of rationale—of Judge Keating's opinion for the New York Court of Appeals in *PATH*.

Of all the cases brought to our attention, *PATH* provides the strongest support for deviating from the market value rule. That case was concerned, among other matters, with the condemnation of four single track railway tunnels under the Hudson River and subterranean tunnels connecting them with passenger terminals in New York and New Jersey. The operation was a hopelessly losing one. The trail court awarded $30,000,000, "predicated on the conclusion that the condemnees should at least be repaid for the depreciated original cost of the tunnels," 20 N.Y.2d at 471, 285 N.Y.S.2d at 32, as against a figure of $400,000,000 for reproduction cost and a zero liquidation value as scrap. The Appellate Division reduced the award to "virtually nothing." The Court of Appeals restored the award of the trial court, saying:

> Can it be said by any objective standard that an award of scrap value—*nothing*—is fair and just for the tunnel property, an essential part of an essential public facility, which cost some $32,000,000 to construct, which would cost in excess of $400,000,000 to reproduce and which, with some minor expenditures will function as good as new for an indefinite period? We think not. . . .

43. The attitude embodied in these cases is encapsulated by Justice Latchford's remark in the *Ottawa and Gloucester Road Co.* case; noting the possibility that the owners should have been paid nothing because the properties had neither positive earning capacity nor scrap value, he said, "I am glad that no such view was taken . . . ." 69 D.L.R. at 494.

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20 N.Y.2d at 470, 285 N.Y.S.2d at 32.[44] While *PATH* is not binding upon us,[45] this decision demands serious attention.

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44. The Court also said:

> We are here concerned with a property which has a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which the petitioner is acquiring the property. It is the owner who built the "reservoir"—the Tube railway system in the present case. This owner has developed its property at a cost of millions of dollars and operated it for more than 50 years. It is admittedly of great usefulness in the daily transportation of thousands of commuters. A condemnor should not be permitted to tell him: "It's only worth scrap or less".

20 N.Y.2d at 468, 285 N.Y.S.2d at 30.

The *PATH* case also involved non-tunnel properties. As to these, while the Court of Appeals disapproved the Appellate Division's award of scrap value "solely on the basis of unprofitability of the enterprise," 20 N.Y.2d at 471, 285 N.Y.S.2d at 32, it also disapproved the trial court's award of $20 million "on the basis of original cost less an amount for depreciation which had no support in the record" on the ground "that much of the non-tunnel property was severely deteriorated, and that an expenditure of almost $32,000,000 would be necessary to rehabilitate the non-tunnel property whereas only $88,000 was all that would be required to restore the tunnels." 20 N.Y.2d at 471, 285 N.Y.S.2d at 33. The court added that the record indicates that, despite rising costs of labor and equipment, the original cost of the non-tunnel property exceeded the depreciated reproduction cost of that property and the award made by Special Term was only some $3,000,000 less than the depreciated reproduction cost. By comparison, the award for the tunnel property, which gave effect to the unprofitability factor, was less than one fifteenth the depreciated reproduction cost. It is thus clear that Special Term not only failed to give effect to the physical and technological obsolescence of the property but that it also apparently ignored the enormous expenditure which was required to rehabilitate the property and did not give any significant effect to the unprofitability factor.

Id.

45. We do not agree with the contention of some transferors that *PATH* was "approved" by the Supreme Court in *The New Haven Inclusion Cases, supra,* 399 U.S. at 482-83, n.80. The Court summarized the holdings of the *Fifth Avenue Coach* and *PATH* cases and said that in neither did the New York Court of Appeals "require the taking authorities to pay *both* an operating and a liquidating value" but rather had "awarded the owners the value reflecting the highest and best use for their properties . . . ." It would go too far to read into the latter remark a

Both the majority and the minority in *PATH* sought to draw comfort from Mr. Justice Cardozo's opinion in *Roberts* v. *New York City*, 295 U.S. 264 (1935). That decision is not easy to understand. The case concerned the valuation of a losing spur of an elevated railroad; the New York Court of Appeals had allowed the scrap value of the spur and the original cost to the railroad in acquiring easements of light, air and access. The railroad's receiver and others allied in interest with him obtained certiorari; the City acquiesced in the decision of the New York Court of Appeals. The subject principally discussed in the Supreme Court's opinion was the adequacy of the award for the easements which if they had to be acquired at the date of condemnation would have cost $3,600,000 as against the original cost of $539,117.41 that had been awarded. The Court held, 295 U.S. at 282, that "the award is not too low, though perhaps it is too high." It pointed out that the easements were useful only in connection with operation of the spur and said, in the words stressed by the dissenting judge in *PATH* and by the Government parties here, that

> Substantial prices are not paid for the privilege of conducting a business at a loss.

Id. The Court also sustained the award of only $235 for the scrap value of the spur, *id.* at 284, saying:

> The structure was appraised as junk, the city having undertaken to bear the cost of removal. *Such an appraisal might be too low were it not for the award for the private easements.* To realize the value of those easements, an abandonment of the spur was necessary. "The railroads could not release their rights to the abutting owners and continue to operate their railroads in the

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requirement that the principle adopted in *PATH* must be applied in federal condemnation.

> street." 265 N.Y. at p. 181. The structure in the circumstances had no value except as scrap. (Emphasis supplied.)

The *PATH* majority, and here the transferors, stress the italicized sentence, which could mean that when the condemnation is of a railway not possessing easements of light, air and access, scrap value would not be enough even when there is no continued use. Against this are the final sentence and the previous discussion. We thus derive little help from *Roberts*.

B. *Applicability of the Market Value Rule to this Proceeding*

While the cases previously reviewed do not carry the weight the transferors would give them, we cannot be wholly insensitive to the views that seem to underlie them. The courts rejected market value as the measure of just compensation in circumstances which made that measure suspect.

Circumstances peculiar to this case make market value particularly hard to prove. The transferors face serious difficulties in proving alternative scenario sales and the amounts that would have been obtained from those sales. These difficulties are increased by the chilling effect, not disputed by the Government, that serious discussion of the Rail Act had on the prospect of such sales. The discussion and enactment of the Act eliminated any incentive other parties might have had to negotiate purchases.

This does not mean that we should reject the role of market value in determining just compensation. Nor, however, should we bind a notion as fundamental as just compensation by the sterile logic of provable market value if a manifestly unfair result is produced. We may have such a situation here. It seems incredible that these 19,000 miles of railway and freight and passenger terminals, together with the equity in rolling stock, were worth only $685 million, the sum arrived at in the revised

MLP of March 1, 1976.[46] It is nearly as unbelievable as the zero award in *PATH*. Of course, the revision of MLP now in progress or attacks on it by the transferors may considerably augment this figure.[47] It may also be that the transferors will succeed in showing a higher value by proving the potential salability of some of the property for rail use. The Government parties might be well advised not to be overly finical in their attitude toward such proof.

It suffices now to note that if the transferors should not be able to establish a figure for NLV which would square with our notions of what constitutes "just compensation," we may be obliged to consider some other method to arrive at CMV. This would not be to deny the thesis of the Government that value to the taker should not be considered. However, if the unique circumstances of this case make it impossible to establish a market value which constitutes just compensation, it may be neccessary to resort to some other rule. As the Supreme Court has pointed out:

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46. Although we have refused to consider value to the taker as a measure of the transferors' compensation, we do take note, as urged by counsel for the PC Trustees, of the spread between the approximately $86 million value placed by MLP on the existing Northeast corridor properties and the $1.6 billion appropriated in Title VII of the Railroad Revitalization and Regulatory Reform Act of 1976, 45 U.S.C. §§ 853, 854, to improve passenger travel time between New York and Boston by 16 minutes and between New York and Washington by 24 minutes. *See* Study of Federal Aid to Rail Transportation, *supra* at VII-14. A spread of this magnitude provides occasion to recall the Supreme Court's frequent iterations that the "word 'just' in the Fifth Amendment evokes ideas of 'fairness' and 'equity' . . . ." *United States* v. *Commodities Trading Corp., supra,* 339 U.S. at 124. *Accord, United States* v. *Virginia Electric & Power Co.,* 365 U.S. 624, 631 (1961); *United States* v. *Fuller,* 409 U.S. 488, 490 (1973).

47. An affidavit of J. Richard Tomlinson, Executive Vice-President of the PC, attached to the opening brief of the PC Trustees indicates that the $685 million figure reflected a large number of zero and negative values. Mr. Tomlinson roughly estimated that some $434 million of negative value had been deducted from the transferors' facilities other than "trackwork." Bridges and terminals are typical of such facilities. While we do not now take a position on the issue, we place the Government parties on notice that substantial proof will be required to convince us of the propriety of deductions for "negative value."

> The Court in its construction of the constitutional provision has been careful not to reduce the concept of "just compensation" to a formula. The political ethics reflected in the Fifth Amendment reject confiscation as a measure of justice. But the Amendment does not contain any definite standards of fairness by which the measure of "just compensation" is to be determined. . . . The Court in an endeavor to find working rules has adopted practical standards, including that of market value . . . But it has refused to make a fetish even of market value.

United States v. *Cors, supra,* 337 U.S. at 332 (citations omitted).

If it should prove impossible to establish a market value which constitutes just compensation, the basis that now seems to us most deserving of serious consideration—whether as the sole basis or as one to be considered along with NLV we need not now determine—is a basis related to original cost. In contrast to most condemnations, the property is not being converted to new uses; ConRail is being substituted for the transferors. In other words, ConRail has been put in roughly the same position it would have occupied had it made the transferors' original investment when they did and depreciated it at the proper rate. Thus, a figure related to original cost may have some relevance to the value of what is being transferred. We use the phrase "related to" since not only must allowance be made for depreciation, but a further deduction might be justified to reflect physical deterioration beyond the point provided by the normal depreciation allowances but not constituting CUE.[48] ConRail is being substituted as the operator of a *deteriorated* railroad. Since ConRail must pay for the deterioration when it rehabilitates the property, the Government should benefit through a deduction in its purchase price (except insofar as the deterioration constitutes CUE). From the standpoint of precedent, use of original cost less depreciation finds

48. The acronym would be OCLD & D.

support in the portion of *PATH* relating to the tunnels. An additional deduction for deterioration would find support in the portion of *PATH* relating to the non-tunnel properties as well as in *In re City of Eureka, supra,* 19 Cal. R.C.D. at 957.

Figures appropriately related to original cost would be entirely "just" to the transferors absent proof of a higher sale value; owners of hopelessly losing properties who are unable to establish a higher net liquidation value would have no just grievance if they receive back their original investment less one or even both of the deductions we have outlined. The Supreme Court's decision in *Roberts* with respect to the easements is authority at least for this. A figure based on original cost has the further advantage of relative ease of determination from records which, except for any deterioration deduction, are readily available in the carriers' reports to the ICC. *See Phillips, The Economics of Regulation* 239 (1965). The Government parties complain that it is not rationally related to the rights of which the transferors have been deprived, and call attention to the portion of Mr. Justice Clark's opinion in *United States* v. *Toronto, H. & B. Nav'n Co.,* 338 U.S. 396, 403 (1949) (footnote omitted), which quoted an economist as saying:

> original cost is well termed the "false standard of the past" where, as here, present market value in no way reflects that cost.

Here, however, we have a case where provable market values may be as inaccurate an indication of just compensation as original cost can be in a more traditional proceeding. And the court was also to say, less than four months after the *Toronto* decision:

> This Court has never attempted to prescribe a rigid rule for determining what is "just compensation" under all circumstances and in all cases. Fair market value has normally been accepted as a just standard. But when market value has been too difficult to find or when its

> application would result in manifest injustice to owner or public, courts have fashioned and applied other standards . . . . Whatever the circumstances under which such constitutional questions arise, the dominant consideration always remains the same: What compensation is "just" both to an owner whose property is taken and to the public that must pay the bill?

United States v. *Commodities Trading Corp, supra,* 339 U.S. at 123 (footnote omitted). While we recognize that this decision, as well as *United States* v. *Cors, supra,* 337 U.S. 325, rejected claims that market value exceeded what the Government deemed to be just compensation, the principle, as stated in the *Commodities Trading* opinion, must work both ways. And what the Government parties regard as a windfall to the owners by an award of more than they can prove to have been obtainable on the market is lessened by the accrual of large prior claims during the lengthy bankruptcy proceedings.

The parties should not read this discussion of original cost to indicate we are bound to it as a factor in valuation. It should be clear that we are not suggesting that a figure related to original cost is the best indication of CMV. Instead, we propose it only as a possible check on shortcomings we fear may develop in the usual valuation method focusing on market values. Furthermore, we would not be surprised to find that revised market value figures were not much different from depreciated original cost. After all, some of the rail property is heavily depreciated and the original cost value of much may be further reduced when deterioration is considered. But in the event a wide disparity should exist, we may not be able to accept as fair any valuation which does not reflect an adjustment related to original cost or a better check on fairness that the parties may suggest. We thus place the parties on notice that we may feel obliged to resort to some kind of analysis related to original cost and that they should present evidence accordingly.

We should also advise the parties, in the interest of their avoiding the expense incident to complex engineering studies, that we do not intend to consider estimates of reproduction cost, variations on that theme such as "assemblage value," value of materials "in place," trended original costs, gross liquidation value or societal values.[49] All these concepts suffer from the basic defect that they are neither values which the transferors were in a position to realize at the time of the taking nor an amount deriving from what they had invested so that there may be some fair claim to having it returned if other methods of arriving at just compensation should fail.[50]

This obviously is not a case where reproduction cost evidence should be receivable on a theory of indemnity, *i.e.*, finding the amount the taker should pay to enable the condemnee to reestablish his business elsewhere, as in the *Foley Square* case, 306 F.2d at 448-49, discussed above, since that is something which the transferors do not wish at all. The transferors' assertion of a

49. In this portion of this opinion we shall sometimes use the term "reproduction cost" to embrace these other theories as well.

50. The PC lienholders assert that failure on our part to take account of reproduction cost would discourage investment in railroads or other public utilities. This is a combination of what Professor Bruce Ackerman, in analyzing utilitarian arguments for just compensation, has called the Appeal to General Uncertainty and Citizen Disaffection. *See Private Property and the Constitution, supra* at 44, 49. However weighty such arguments may be in forbidding an award that would be a mere pittance because of insuperable difficulties in establishing fair market value, we fail to see how they support consideration of reproduction cost. No one buys a railroad's bonds or stocks in the expectation that the road will become bankrupt or that the government will take it over if it does. Still less could investors have expected that in such events the Government would pay many times what could have been obtained by way of a sale or what it had cost to build the railroad in the first instance. All that can be said is that investors in railroad securities reasonably expect that if their property should be taken, they, like all other property owners, will be treated fairly. Applying Professor Ackerman's formula that under the utilitarian view compensation should be given when and only when $P < U + D$, where P = process costs, U = uncertainty costs and d = the costs of citizen disaffection, p. 48, the test plainly would not be met if P were influenced by reproduction cost. Indeed, there might be citizen disaffection over the payment of what would seem a grossly excessive amount.

right to present reproduction cost evidence is based rather on a theory of value to the taker or on some reified notion of property, concepts which we have rejected earlier in this opinion.

Although the transferors have not said what RCNLD would amount to, it is clear that the figures would be tremendous. To take one example, the Penn Central estimated its RCNLD as of December 31, 1970, as some $13 billion as against December 31, 1975 book value of $3.6 billion, FSP, Vol. I, at 142; as a result of inflation the disproportion would probably be greater today. EL estimated its RCNLD as of December 31, 1973, as some $3.6 billion as compared to a book value of $318 million. *Id.* While we understand these figures relate to the entire estates (including non-operating properties) and not simply to the portions transferred, the disproportion remains significant. The railroads in the eastern district have not earned a rate of return on *book value* as high as 4% for the past dozen years; the rates of return for the years ending March 31, 1968, 1969 and 1970 were 1.51%, 1.33% and .37%. *See* The American Railroad Industry: A Prospectus 48 (America's Sound Transportation Review Organization 1970). Moreover, since the Supreme Court's decision in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), the railroads are not even *entitled* to earnings constituting a fair return on a reproduction cost rate base; the ICC permissibly uses a net investment value rate base. *Net Investment-Railroad Rate Base & Rate of Return,* 345 I.C.C. 1494, 1514-42 (1976). *See also* Note, *Con-Rail and Liquidation Value: Creditors' and Stockholders' Entitlement in the Regional Rail Reorganization,* 85 *Yale L.J.* 371, 375 (1976). It would be a strange notion of "just compensation" that would require the taxpayers to pay so much more for these properties in their deaths than they had been worth during their recent lives. On this point we find *Market Street Railway, supra,* 324 U.S. at 567, although a rate case under the due process clause rather than a condemnation case under the just compensation clause, to be very nearly decisive.

Apart from these basic conceptual defects, resort to reproduction cost as a measure of value in a case like this would lead into a never-never land where this court and the parties would perforce spend long years in the quest of a goal that is unattainable and not worth attaining.

In the first place, despite the deceptive simplicity of the terms, no one knows what RCNLD means. Hartman's book on *Fair Value* at 100 (1920) more than a half-century ago noted that attempts to define the term had developed along three general lines: (1) the cost of reproducing a plant similar in all essentials to the existing plant, under present conditions; (2) the cost of reproducing a similar plant at present prices, under conditions prevailing at the time of original construction; (3) the cost of constructing a substitute plant capable of performing the same service. *Hartman, supra,* at 100. The list is not exhaustive. *See Bonbright* at 152: *Phillips, supra,* at 241-42. Under any of the approaches, the reproduction cost figure would have to be depreciated on some basis to reflect the age and also the deteriorated condition of the present plant, except so far as deterioration might constitute CUE; there would surely be no fairness in taking the cost of building a plant to provide efficient "substitute service" when, due to chronic undermaintenance, the existing service was far below the service of which the older technology was capable. Also, under the circumstances here, there would seem to be no reason for theorizing the construction of a plant "capable of performing the same service" when there is not and may never be a demand for that service; one of the reasons for the transferors' plight has been the underutilization of their plant, *see* PSP, Vol. I, at 4, and there is no assurance that this has been fully remedied by FSP, which was necessarily a compromise to some degree. *See, e.g.* FSP, Vol. II, at 2-5 (light density lines).

Perhaps enough has already been said to illustrate the interminable debate among engineers and other experts which any attempt to arrive at the reproduction cost of the properties here at issue would engender. The experts and ultimately this Court

would have to sort out the various senses in which one can "reconstruct" a railroad. Is one required simply to provide service between cities, or does "reconstruction" entail the duplication of all existing spur connections to industrial shippers, although they could reach the main line more efficiently by truck? Would the substitute service have to be equivalent to existing service, with slow orders of 10 m.p.h. on much of the track, or would it have to be the equivalent of the service that would have been offered by a well-maintained version of the former railroad? In computing the cost of land for track, freight yards and terminals, must one assume use of the existing sites, or may cheaper ones be substituted? On either view, is one to take account of increased land values due in part to the presence of the railroad and in part to the efforts of others; or is one interested in what it would cost to reconstruct a railroad if the existing ones had never existed?

These definitional difficulties are augmented by additional problems of calculability. While some of these have been anticipated in our discussion, further elaboration may be useful. Perhaps the most difficult question is how to make allowance for functional depreciation. Mr. Justice Brandeis thought that functional depreciation should encompass not only "progress in the art of rail transportation" which has reduced the value of the existing plant. *St. Louis & O'Fallon Ry.* v. *United States*, 279 U.S. 461, 523 (1929) (Brandeis, *J.*, dissenting) but also changes in the volume or character of a railroad's traffic or in the nature of the community it serves that would lead to alteration in rail system design if the railroad were to be rebuilt. *See also* 2 *Orgel* at 111; *Bonbright* at 161, 168, 215.

The uncertainties in calculating functional depreciation are rivalled by the difficulties of arriving at the initial estimate for RCN. In his *O'Fallon* dissent, Mr. Justice Brandeis noted, in terms fully applicable here, that "there was practically no construction of new lines" during the recapture years there in question, making it very difficult to estimate current construction costs; on the other hand, indexing construction costs from earlier

years was unsatisfactory since it gave no effect to new cost-saving methods of construction, 279 U.S. at 544-45. *See also Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Comm'n*, 262 U.S. 276, 299-300 (1923) (Brandeis, *J.*, dissenting); *Bonbright* at 166-67.

Commissioner Eastman of the ICC also considered that RCN estimates were unreliable, for they were "based on all manner of assumptions, and invade the realm of fancy at numerous points." He cited, as one example, not without applicability here, that the estimate of RCN for a given segment of railroad would depend on how many other railroads were hypothetically being reproduced, since it is more expensive to construct a railroad if no other railroads are available for the transport of construction materials. *San Pedro, Los Angeles & Salt Lake R.R.*, 75 I.C.C. 463, 530 (1923) (dissenting opinion), *modified*, 103 I.C.C. 398 (1925).[51]

Another type of objection to RCN as a valuation method is based at root on considerations of equity. RCN under prevalent methodology would take no account of the fact that the original construction of the railroad was done in a timely fashion. In regard to land, for instance, basing the value on the current market price of adjoining land would amount to positing the reconstruction of the railroad with the least efficient timing possible in the development of an industrial area. *See San Pedro, Los Angeles & Salt Lake R.R., supra*, 75 I.C.C. at 549. Judging the RCN of land by the current value of adjoining real estate has in addition the unwarranted effect of penalizing state and local governments for public improvements undertaken by them. The increased value of the land on which a railroad has been built is the result not simply of the construction of the railroad but of what the New York Court of Appeals has recently termed "the massive and indistinguishable public, governmental and private contributions," *Penn Central Transportation Co.* v. *New York*

51. *See also* 1 *Kahn, The Economics of Regulation: Principles and Institutions* 39 (1970), *quoting* 2 *Lyon & Abramson, Government in Economic Life* 691 (1940).

City, ___ N.Y.2d ___, ___, ___ N.Y.S.2d ___, ___ (1977).

Finally, it is hard to see why investors, and particularly bondholders in bankrupt railroads, should enjoy a bonus for the effect of inflation not accorded to most other citizens. Commissioner Eastman inquired in his *San Pedro* dissent, 75 I.C.C. at 532:

> [W]hy should public utility investors be constituted a favored class exempt from the hardships suffered by other investors due to the change in the purchasing power of the dollar?

See also Mr. Justice Brandeis in *Southwestern Bell, supra*, 262 U.S. at 305, 307. While in fixing rates for operating utilities it may well be necessary to take appropriate account of the increased cost of replacing facilities constructed at substantially lower prices, there is no corresponding consideration here.

The difficulties in the use of RCNLD are not decreased by the suggestion of some of the transferors, apparently embarrassed at the size of the award on a reproduction cost theory alone, that we need not take RCNLD as "the value" but simply as a factor to be considered along with OCLD and NLV in arriving at value. Rather they are augmented. As Commissioner Eastman noted in his *San Pedro* dissent, it is one thing to apply RCN as a check on estimates of OC when the range between the two is narrow, but is a quite different thing when a long period of price change has produced a vast difference between the two. Under such circumstances the choice of a figure becomes increasingly arbitrary. 75 I.C.C. at 553-54.[52]

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52. Commissioner Eastman stated:

> I must confess that it seems to me that unless some definite standard can be found for determining the weight to be given to such widely conflicting evidence, the process of valuation will become arbitrary to a degree wholly impossible to defend. Value will become a speculative and capricious matter, varying millions of dollars upon exactly parallel sets of facts, dependent upon the

We are told that, however all this may be, authority compels us to plod into the morass of taking evidence on RCNLD "for whatever it may be worth"—the hope being apparently that a decade hence, when this job has been completed,[53] we—more accurately, our successors—will have a different perception of the bearing of such figures than we do now. We have already discussed and rejected the lines of authority that are most nearly pertinent although not sufficiently so as to be persuasive. Only a little more needs to be said.

One line of cases, cited to us not as binding authority but as "an instructive analogy to the present valuation task", Reply Brief of Intervening PC Lienholders at 42-47, consists of decisions of the ICC under § 3(5) of the Interstate Commerce Act:

> If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a common carrier by railroad owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power by order to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal, of any common carrier by railroad, by another such carrier or other such carriers, on such terms and for such compensation as the carriers affected may agree upon, or, in the event of a failure to agree, as the Commission may fix as just and reasonable for the use so required, to be ascertained on the principle controlling compensation in condemnation proceedings.

49 U.S.C. § 3(5).

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bent of mind, temper, and perhaps, digestion of the particular individuals who happen to exercise the "judgment."

Id.

53. We are quite serious about the time estimate. The ICC's valuations of the country's railroads under § 19a of the Interstate Commerce Act required 19 years. *See* III-A *Sharfman, The Interstate Commerce Commission* 39-40 (1935).

Appendix E

The leading decision under § 3(5) (at the time, § 3(4)) is *Missouri-Kansas-Texas R.R.* v. *Kansas City Terminal Ry.*, 198 I.C.C. 4 (1933) (*MKT*). The Commission there sought to fix the compensation to be paid to Kansas City Terminal (KCT) for MKT's use of portions of the terminal facility. The Commission first disposed of preliminary contentions, ruling that since MKT was in effect a tenant, just compensation could be in the form of rental payments, rather than in a lump sum. The Commission also directed MKT to pay a rental based on its numerical share (as one of 12 users of the property) rather than on a user basis. Moving to the determination of the fair value of the property, the Commission discussed the valuation principles it thought applicable:

> Before proceeding to discuss the evidence and our conclusions relative thereto, we repeat it is our interpretation of the statute that the principles controlling compensation in condemnation statutes are fully applicable and appropriate to determine the value of the property for the use of which compensation is to be made. Insofar as the rules, methods, and principles laid down by us in our valuations under section 19a of the act are applicable, we shall be controlled thereby. At the same time we recognize the distinction between the controlling principles applicable for the ascertainment of values for rate-making purposes and those applicable in condemnation cases. We do not perceive, however, why the principles applicable for the determination of individual elements, such as cost or reproduction, cost of reproduction less depreciation, and original cost, should be any different in the instant case from those in the rate-making case. It is true that certain facts—earnings for instance—may be relevant in condemnation cases while irrelevant in rate-making cases, but if the facts are relevant the controlling principles in their ascertainment should be the same.

198 I.C.C. at 14.

This seems to us little more than saying that the Commission proposed to apply its *San Pedro* and *O'Fallon* decisions concerning the factors to be taken into account in valuation for ratemaking purposes under § 19a as a guide for its decisions under § 3(5). *See also* III-A *Sharfman, supra,* at 124 (noting that § 19a was "a statutory replica [of] *Smyth* v. *Ames*"). The undermining of *San Pedro* and *O'Fallon* by the Supreme Court's decision in *Hope Natural Gas* deprives *MKT* and its progeny, including cases that applied *MKT* in fixing fair and equitable terms and conditions for acquisitions under § 5(2), *e.g., Use by Erie R.R. of Niagara Junction Railway Terminals,* 278 I.C.C. 425 (1950), of any precedential authority for us.

The Brief of the PC Lienholders at 161-62 & n.145, also tells us that "In public utility condemnation cases the reproduction cost of the facility is invariably a significant measure of value," and that "Reliance on reproduction cost is common in federal and state courts." Some of the cases cited are ratemaking cases, which must be deemed to have been overruled by *Hope Natural Gas, see Market Street Railway, supra,* 324 U.S. at 566-68. One of the condemnation cases cited is *PATH,* which, as we read it, gave no weight to reproduction cost for the losing tunnel properties. Another is *Fifth Avenue Coach.* We have declined to follow that case in other respects; moreover, whatever authority it might have lent to the use of reproduction cost in valuing an unprofitable utility is undermined by the subsequent decision of the same court in *PATH.* One case cited, *In re City of Oroville, supra,* [1922E] P.U.R. at 469-70, quite clearly rejected RCN and RCNLD. Still other cases have been discussed in Part IV(A)(5) of this opinion.

More clearly inapplicable are cases in which there is no indication that the utility was hopelessly unprofitable, *City of Omaha* v. *Omaha Water Co.,* 218 U.S. 180 (1910); *Albert Hanson Lumber Co.* v. *United States,* 261 U.S. 581 (1923); *Wichita Water Co.* v.

City of Wichita, 271 F. 973 (D. Kansas 1921), *rev'd*, 280 F. 770 (8 Cir. 1922), *City of Baxter Springs* v. *Bilger's Estate*, 110 Kan. 409, 204 P. 678 (1922), or in which it is clear from the opinion that the condemned utility was profitable or likely to become so. *National Waterworks Co.* v. *Kansas City*, 62 F. 853 (8 Cir. 1894); *United States* v. *Boston, Cape Cod and N.Y. Canal Co., supra*, 271 F. 877; *Puget Sound Power and Light Co.* v. *Public Utility Dist. No. 1*, 123 F.2d 286 (9th Cir. 1941), *cert. denied*, 315 U.S. 814 (1942); *City of Phoenix* v. *Consolidated Water Co.*, 101 Ariz. 43, 415 P.2d 866 (1965); *Dade County* v. *General Waterworks Corp.*, 267 So.2d 633 (Fla. 1972); *Kennebec Water Dist.* v. *Waterville*, 97 Me. 185, 216, 54 Atl. 6, 19 (1902); *Montgomery County* v. *Schuykill Bridge Co.*, 110 Pa. 54, 20 Atl. 407 (1885); *Borough of Hanover* v. *Hanover Sewer Co.*, 251 Pa. 95, 96 Atl. 132 (1915); *Appleton Waterworks Co.* v. *Railroad Comm'n, supra*, 154 Wis. 121, 142 N.W. 476. RCNLD may be a tenable measure of the value of the opportunity to continue a profitable enterprise, as we have noted, but it has no relevance here.

Beyond this, many of these cases stem from the heyday of *Smyth* v. *Ames* and even more extreme Supreme Court decisions extolling the role of reproduction costs in public utility valuation for rate-making purposes, *e.g.*, *McCardle* v. *Indianapolis Water Co.*, 272 U.S. 400 (1926). It is natural that this should have had a spillover into public utility condemnation; and when the utility was a profitable one, earning a return on a RCNLD rate base, reference to RCNLD as a factor would have been not only natural but perhaps defensible, see the remarks of later Chief Justice Taft as a dissenting arbitrator in *Grand Trunk Ry.* v. *Rex*, [1923] A.C. 150, 162-63 (Privy Council) and *Bonbright* at 156, although it is hard to see just what evidence of RCNLD added to the capitalization of earnings upon it that would have gotten to the point more directly, *see* 2 *Orgel* § 210, at 89. The remarks in 2 *Orgel* § 210, at 88 and in *Bonbright* at 151 and 153 can be

similarly explained; neither asserts that replacement costs must be considered in the condemnation of a losing public utility.

In sum, the time has come "to lay the ghost of *Smyth* v. *Ames*," *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 602 (1942) (Black, Douglas and Murphy, J.J., concurring), not only in ratemaking but, to such extent as it has lingered there, in eminent domain, except under such special circumstances as existed in the *Foley Square* case, *supra*, 306 F.2d at 447-48, and in the cases involving condemnation of property not held for profit. Reproduction cost evidence should be received in condemnation proceedings only when, as in such cases, it affords needed assistance to a court in finding what will be an appropriate indemnity for an owner wishing to continue to devote his property to its existing use. That, as we have several times pointed out, is not this case. We thus will not permit the masters to take evidence on reproduction cost, assemblage value, value of materials "in place," trended original cost, gross liquidation value or societal values unless a particular transferor can bring himself within the principal of *Foley Square*.[54] While the transferors are free to make offers of

54. We also reject the contention that the transferors are entitled to an allowance for the "going concern" value of their properties despite their unprofitability. Most of the cases cited which allow compensation for going concern value involve profitable utilities, *e.g.*, *National Waterworks Co.* v. *Kansas City*, *supra*, 62 F. at 865, *City of Phoenix* v. *Consolidated Water Co.*, *supra*, 101 Ariz. at 46, 415 P.2d at 869; *Dade County* v. *General Waterworks Corp.*, *supra*, 267 So.2d 633; *Brunswick & T. Water Dist.* v. *Maine Water Co.*, 99 Me. 371, 376, 59 Atl. 537, 539 (1904); *Borough of Hanover* v. *Hanover Sewer Co.*, *supra*, 251 Pa. at 99, 96 Atl. at 134; *Oshkosh Waterworks Co.* v. *Railroad Comm'n*, 161 Wis. 122, 131, 152 N.W. 859, 863 (1915). One case, *City and County of San Francisco* v. *Pacific Gas & Electic*, [1929E] P.U.R. 529 (Cal. Railroad Comm'n 1929), concerned property taken from a company that continued in business. In another decision, which did involve an unprofitable utility, In re *Fair Oaks Irrigation Dist.*, *supra*, [1918C] P.U.R. at 884, the California Railroad Commission noted only that it would give some consideration to net earnings, of which the utility had none.

We have already indicated our disagreement with the holding of *Fifth Avenue Coach*, *see* pp. 56-57, *supra*. To the extent that *PATH*, *supra*, 20 N.Y.2d at 471-72, 285 N.Y.S.2d at 33, followed that decision with respect to going concern value, we disagree with it as well. As Judge

proof on any or all of these themes, we strongly suggest that they curtail expenditures on such studies to the minimum needed to enable them to make intelligible offers of proof; in turn, we shall not fault them for any deficiencies in the offers resulting from such a curtailment.

V. *Sales to Other Public Bodies*

In this section we deal further with the argument of the Government parties that the alternative scenario may not include sales to other public bodies or, at minimum, may not include sales to such bodies by way or in lieu of condemnation. We have previously indicated in Part III that, as a matter of statutory construction, we see no reason why such sales should not be includible in determining NLV; however, that would serve little purpose if they were required to be excluded for purposes of determining CMV.

In this Court's June 16, 1976 Memorandum, we requested briefing on the question whether, in determining NLV under § 306, account should be taken of potential rail use sales at prices greater than nonrail NLV "when the proposed sale is to a public body vested with the power of eminent domain, in the absence of proof of a private purchaser ready and willing to make the purchase?" 425 F. Supp. at 283. The consequent briefing centered on one aspect of that question: whether any such public (or private) purchasers would in fact pay more than salvage value, with the Government parties arguing that they would not in light of the claimed ability and policy of the ICC to condition permission to abandon with a "salvage value clause" requiring the applicant to sell for continued operation at not less than net salvage value. We indicated in our October 18, 1976 Opinion that we were not persuaded by the Government's contention that such clauses had any effect other than that, as between two purchasers

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Burke observed in his *PATH* dissent, "Economic viability, i.e., the capacity to operate at a profit, is . . . the *sine qua non* for an award of going concern value." *Id.* at 480-81, 285 N.Y.S.2d at 40-41.

neither of which was willing to pay more than scrap value, the railroad must prefer the one that would continue operations, and that the willingness of a public body, even in the absence of competition, to pay more than scrap value, was a matter of proof, *see* 425 F. Supp. at 271-73. We now reaffirm that initial conclusion, along with our rejection, *id.*, of the Government's broader assertion that ICC regulation in the absence of the Act would and could have reduced the price for all rail use dispositions to nonrail NLV; *see* pp. 31-32 & n.19 *supra.*

As a result, another aspect of the question of sales to public bodies, previously somewhat obscured by the controversy over the salvage clause, becomes significant. This is whether, assuming that public bodies would in fact pay more than salvage value, it is permissible as a matter of condemnation law to include them in the market. The Government parties claim that, absent a showing that the purchase would have been made in the expectation of profitable operation, it is not. The argument is that consideration of state and local governmental bodies as purchasers, *first,* would run contrary to the eminent domain principle that even actual increases in private market value are not compensable if attributable to the same public project for which the property was taken, and *second,* that taking account of such prospective purchasers would unacceptably burden the exercise of federal power.

The Government's invocation of the "same project" limitation on actual market value as of the time of the taking is unavailing. We follow the Government parties in their claim that any increases in market value resulting from the *taker's* project are to be excluded in computing the amount the taker must pay. *See Shoemaker* v. *United States,* 147 U.S. 282, 303-05 (1893); *United States* v. *Miller, supra,* 317 U.S. at 375-77; *United States* v. *Cors, supra,* 337 U.S. at 332-34. But the putative interest of a public body in acquiring properties for continued rail use is independent of the effort by the Federal Government, the taker in this case, to secure such a continuation through the Rail Act. The proposition that a condemnee is not entitled to compensation for

demand attributable to the taker's very project does not compel the conclusion that he is not entitled to value for uses for which other condemnors would have paid in order to serve the same purpose—preservation of rail service—as is served by the actual taker's project;[55] to employ the "same project" vocabulary is only to state the public sales issue here under consideration in another way.[56]

The Government's reliance on the decision in *United States* v. *124.21 Acres of Land*, 458 F.2d 568 (8 Cir. 1972), on this score is misplaced. The court there indicated that demand for borrow material created by the interstate highway project for which the material was taken by the Federal Government may not be considered. It refused to consider as market value prices previously paid by the state of Minnesota for such material, apparently because that purchase also had been for use on the same highway construction. Exclusion of the state's purchase on this ground was simply an unexceptional application of one aspect of the same project doctrine; unlike the issue here with respect to purchases by public bodies, Minnesota's demand for the fill dirt was a direct result of the project of the federal government, the taker.

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55. This distinction is not called into question by application of the "same project" rule to a federal taking for the use of a local government, *see United States* v. *First Pyramid Life Ins. Co.*, 382 F.2d 804, 806-07 (8 Cir. 1967), or to situations involving related condemnations by the federal government and a state, *compare United States* v. *137 Acres of Land*, 406 F.2d 1283 (6 Cir. 1969), *with United States* v. *390.71 Acres of Land*, 352 F. Supp. 735 (E.D. Ill. 1972).

56. We do note that, wholly apart from the necessity of excluding from the alternative scenario other possible federal responses to the rail crisis, the reasoning of the "same project" cases would require the exclusion of public sales whose likelihood is premised on a federal taking of other rail properties (for example, of connecting lines), for in such a case the amount to be paid by the taker would be increased by demand for which his taking was a necessary condition. And we again note that proof of public sales will have to contend with "[the Government's] claim that a state would not be interested in making the substantial payments required for taking over main line (as distinguished from commuting) operations without assurance that other states would take similar action to the extent required to constitute a viable system." October 18 Opinion, 425 F. Supp. at 273 n.5.

Such Supreme Court opinions as exist lend support to the proposition that other potential condemnors may be considered, although the Court's discussion has not been altogether clear. The lack of clarity is largely due to the fact that the cases, like those dealing with inclusion of the taker in the market, *supra*, Part IV, generally deal also with a separate issue—whether a condemnee is entitled to values that could be realized only if his property were united with those of others. The general answer is that when this could be accomplished only by someone's exercise of eminent domain, he is not. *See McGovern* v. *New York*, *supra*, 229 U.S. 363; *City of New York* v. *Sage*, *supra*, 239 U.S. 57; *United States ex rel. Tennessee Valley Authority* v. *Powelson*, *supra*, 319 U.S. at 275-79. *See also In re Bensel*, 230 F. 932 (S.D.N.Y. 1916) (remand of *Sage*) (L. Hand, J.). This follows logically from the rule which excludes value to the taker, as such land has assemblage value only to a taker with eminent domain power, not to a seller who lacks such power.

Probably the leading case on the inclusion in the market of public bodies other than the taker is *Olson* v. *United States*, *supra*, 292 U.S. 246. The Court there considered whether reservoir use was relevant to the just compensation owed for a taking of certain flowage easements.[57] In the course of affirming the exclusion of reservoir use on the ground that such use was insufficiently probable absent the taking, the Court said, 292 U.S. at 256:

> . . . The fact that the most profitable use of a parcel can be made only in combination with other lands does not necessarily exclude that use from consideration if the possibility of combination is reasonably sufficient to affect market

57. Although the condemnation statute there provided for compensation in accordance with the constitution of Minnesota, 292 U.S. at 250, the Court noted that the standard "is not, at least so far as concerns these cases, to be distinguished from that expressed by the just compensation clause of the Fifth Amendment and implied in the due process clause of the Fourteenth Amendment to the Federal Constitution," *id.* at 254.

> value. Nor does the fact that it may or is being acquired by eminent domain negative consideration of availability for use in the public service. *New York* v. *Sage*, 239 U.S. 57, 61. It is common knowledge that public service corporations and others having that power frequently are actual or potential competitors, not only for tracts held in single ownership but also for rights of way, locations, sites and other areas requiring the union of numerous parcels held by different owners. And, *to the extent that probable demand by prospective purchasers or condemnors affects market value, it is to be taken into account.* (Emphasis supplied.)[58]

Although the opinion thus referred to the "most profitable use" of the property, the Government parties' effort (Government Br. at 254-55 n.299) to limit the Court's language to cases where public buyers are looking to the profitability of the property in question is unpersuasive since it seems more likely that the Court meant only to refer to the idea of most advantageous use in the sense of that yielding the highest price to the condemnee. The actual holding that reservoir use was too speculative, 292 U.S. at 260, was based rather on the Court's conclusion that the condemnee had not sustained the burden of showing that in fact there were other potential purchasers or condemnors for reservoir use.

The opinions in *United States* v. *Miller, supra*, 317 U.S. 369, and *United States* v. *Cors, supra*, 337 U.S. 325, also contain language suggesting that other public bodies vested with the condemnation power may be included in the market. In *Miller*, the Court said, 317 U.S. at 375:

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58. The Court here cited *Boom Co.* v. *Patterson, supra*, 98 U.S. 403, where an award including use of the condemned property for boom purposes was upheld on the ground that such use was available to persons other than the taker, although the opinion seemed to assume that adaptation for boom use would not require an exercise of eminent domain by the supposed other users and did not indicate whether such users included public bodies. *See* 98 U.S. at 408-09, and the discussion of the case in 1 *Orgel* § 90, at 376.

> [A]lthough the market value of the property is to be fixed with due consideration of all its available uses, its special value to the condemnor *as distinguished from others who may or may not possess the power to condemn,* must be excluded as an element of market value. (Footnotes omitted, emphasis supplied.)

See Note, *supra,* 90 *Harv. L. Rev.* at 600 n.20. To the same effect, the *Cors* Court stated, 337 U.S. at 333:

> The special value to the condemner *as distinguished from others who may or may not possess the power to condemn* has long been excluded as an element from market value. (Emphasis supplied.)

In both instances, the Court cited *United States* v. *Chandler-Dunbar Co., supra,* 229 U.S. at 76-77, where value for lock and canal use was included:

> The exception taken to the inclusion as an element of value of the availability of these parcels of land for lock and canal purposes must be overruled. That this land had a prospective value for the purpose of constructing a canal and lock parallel with those in use had passed beyond the region of the purely conjectural or speculative. That one or more additional parallel canals and locks would be needed to meet the increasing demands of lake traffic was an immediate probability. This land was the only land available for the purpose. It included all the land between the canals in use and the bank of the river. Although it is not proper to estimate land condemned for public purposes by the public necessities or its worth to the public for such purpose, it is proper to consider the fact that the property is so situated that it will probably be desired and available for such a purpose. Lewis On Eminent Domain, § 707.

Boom Co. v. *Patterson*, 98 U.S. 403, 408; *Shoemaker* v. *United States*, 147 U.S. 282 . . . .

The *Miller* and *Cors* Courts apparently read this not as a departure from the general rule against taking account of value to the taker but as indicating that value for the same *purpose* as the taker's to other purchasers or condemnors is includible.[59]

Despite all this we find appreciable force in the Government parties' argument that considering other public purchasers might threaten the ability of the federal government to solve national problems through use of the condemnation power whenever the problem also impacts at the state and local level—a point which does not appear to have been brought to the Supreme Court's attention in any of the cases we have discussed. The effective result of including such purchasers in the market, the Government says, would be that despite the disallowance of "hold up" value when considering the condemnee-federal condemnor relationship, we would then allow a similar "hold up" to enter the calculation of just compensation through the back door of hypothetical dispositions to other public bodies. It is not a sufficient answer to say that doing this does not bar the federal government from resort to condemnation solutions but affects only the just compensation figure. (*See* EL reply brief at 13.) If a state or

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59. To be sure, that portion of *Chandler-Dunbar* has been narrowly confined, *see United States* v. *Twin City Power Co.*, 350 U.S. 222, 226-227 n*. (1956); *United States* v. *Rands*, 389 U.S. 121, 126-27 (1967), though not so as to exclude consideration of other public purchasers.

There is one oddity here. Aside from relying on *Boom Co.* v. *Patterson*, discussed in note 59, *supra*, the *Chandler-Dunbar* Court's supporting discussion of *Shoemaker* v. *United States*, *supra*, 147 U.S. 282, shows that the Court thought *Shoemaker* had approved an instruction that if the taken property "'is peculiarly adapted to some particular use—e.g., to the use of a public park—all the circumstances which make up this adaptability may be shown, and the fact of such adaptation may be taken into consideration in estimating the compensation,'" *see* 229 U.S. at 78, while in fact *Shoemaker* approved the refusal to give that instruction. *See Shoemaker*, *supra*, 147 U.S. at 304-05; 1 *Orgel* at 364-65.

local government, by an improvident arrangement with the condemnee, could dictate what the Federal Government must pay for its decision to condemn, the federal condemnation power would in some degree be hostage to those levels of government.

The problem is sufficiently troubling that we think it preferable, before attempting anything like a complete resolution, to await factual development which will enlighten us as to the true dimensions of the issue. The Government is clearly entitled to be protected against prices that would represent simply the appraisal of a state or local body of how much it would pay under duress rather than have service cut off. Payment of any such price would be unreasonable. The state and local bodies themselves had or could readily have been given the power of eminent domain, including power to take title without contemporaneous payment so long as they recognized "the absolute right of the owner, upon his property being taken, to just or reasonable compensation therefor, and [made] provision . . . for the ascertainment . . . of the compensation to which, under the constitution, he is entitled." *Sweet* v. *Rechel*, 159 U.S. 380, 404 (1895). Value to the taker should no more be admissible in state than in federal condemnation. Also, under the special circumstances of this case, the Federal Government should not be deemed a potential buyer in a hypothetical state or local condemnation; Congress was clearly willing to bow out if state or local bodies would come in. Beyond that we deem it best to rest for the present on what we have previously said, 425 F. Supp. at 273.

VI. *Severance Damages*

Our June 16, 1976 order requested briefing and argument on the issue whether compensation was due for "any diminution in value of the assets severed and then left with the transferors, on a theory of inverse condemnation or otherwise." 425 F. Supp. at 287.

To no one's surprise the transferors answer in the affirmative, referring to 4A *Nichols, supra* § 14.231 and the many authorities

there cited. While asking that we endorse this general proposition, the PC Trustees consider that it would be unwise for us to go further at this time since the method for computing severance damage may vary according to the general theory of valuation that is adopted.

Not disputing the general principle advanced by the transferors, the Government parties urge that it can have little or no application in this case since the condemned rail properties have been taken for continued rail use. Accordingly "[W]hat was railroad property stays in rail use, and what was railroad frontage remains railroad frontage after the Government has acted." (Govt. brief at 239). It follows, they say, that "any 'severance damage' claim must be based on an allegation that retained properties could have been combined with transferred properties to produce greater aggregate value in the absence of the Rail Act" (Govt. brief at 242) and that all this will be reflected in "the alternative scenario."

While the formulation of the Government parties may cover most of the instances of severance damage, we are not satisfied that it would cover all. Moreover, to insist that all claims of severance damage should be handled by the alternative scenario approach might well put an undue strain on this already heavily burdened device. If a transferor prefers to attempt to establish severance damage on a parcel-by-parcel basis, we do not now perceive any reason for preventing this.

However, we agree that for us now to say more would be premature. We therefore content ourselves with the statement that we see nothing that should prevent application of the principle of severance damage in this case.

VII. *The New Haven*

In our June 16, 1976 memorandum we asked for briefing and argument on a "question raised by the statement of the New Haven Trustee, whether there is any requirement that the properties conveyed by the New Haven to PC should be valued on any

higher basis than other properties," 425 F. Supp. at 287, and allowed the Trustee to intervene "for the limited purpose of presenting contentions pertaining *specifically* to properties transferred by the New Haven estate to Penn Central." *Id.* at 288. (Emphasis supplied). Disregarding this limitation, as he had in his brief on CUE, counsel for the New Haven Trustee has filed a brief and reply brief totaling 104 pages, in which the only specific reference to the New Haven is a conclusory statement in a footnote:

> ". . . the findings of the Supreme Court with respect to value of the New Haven properties established the net salvage value of those properties as of December 31, 1966, and, after proper adjustment to date of conveyance to ConRail, set an absolute floor on the salvage value of the New Haven properties in these proceedings." Br. at 4 n.4.

We agree with the Government parties that the former New Haven properties should not be valued differently in these proceedings simply because they were the subject of valuation at the time of their sale to Penn Central. As previously noted, note 42, *supra,* that valuation stemmed from an agreement between Penn Central and the NH Trustees. While the Government was a party to the *New Haven Inclusion Cases,* its interest was that of supporting the ICC's orders and was not that of a condemnor. Moreover, what was there determined was the liquidation value of the entire NH as of December 31, 1966; the question here is the value of what remained of a portion of those properties,[60] after further physical deterioration, as part of the Penn Central on April 11, 1976.[61] We shall expect the NH Trustee in the future to observe the limitation placed on his intervention; indeed, we see

60. One of the most important assets conveyed by the New Haven to PC, its interest in "the Park Avenue properties" in New York City, was not conveyed in 1976.

61. It goes without saying that we intimate no view as to how the claims of the New Haven Trustee against Penn Central are to be treated by the Penn Central reorganization court.

little need for his further participation in these general proceedings as distinguished from proceedings relating specifically to former NH properties.

VIII. *Value of Other Benefits (VOB)*

In Part IV of our Memorandum of June 16, 1976, 425 F. Supp. at 284, we directed USRA to file a more detailed explanation and calculation of VOB than was contained in the FSP, with the hope that this would enable us to rule on issues of principle and thereby reduce the need for further discovery or factual presentations. As noted at the beginning of this opinion, after this statement was filed we fixed a briefing schedule which permitted the VOB problem to be brought on for argument at the same time as the other issues dealt with in this opinion.

The December 1, 1976 Statement of the Government parties gave this subject a turn we had not expected. Departing from the analysis in FSP, Vol. I, pp. 128-34, the Government parties drew a sharp distinction between what their VOB claims would be under the alternative constitutional claims they assert the transferors are entitled to make: First, "they are entitled to assume the *presence* of the Rail Act" and to claim a right to withdraw *all* their properties from rail use. Value is calculated using the MLP. Second, "they are entitled to assume the *absence* of the Rail Act, and try to establish the values they could have attained by liquidating the transfered properties, for rail *or* non-rail use . . . ," under an alternative scenario.[62] Statement at 5 (emphasis added).

Under the first hypothesis the Government's VOB claims are limited to two categories: One is a "technical adjustment" for part of the enhancement in value of a portion of a retained parcel of

62. The Statement made no attempt to analyze what the Government's VOB claims would be on other valuation theories urged by the transferors, saying only that "VOB would, of course, be present on all such theories." P. 2 note *.

land by virtue of its access to ConRail service. The other category is the elimination of claims that would have been reached in a reorganization to the extent that these exceed the value of the related properties. Illustrative and most important is ConRail's assumption of equipment obligations. Section 303(b)(3)(A)(ii) provides in part that conveyance of rolling stock (defined to include locomotives, freight and passenger cars, and work equipment) may be effected only if—

> (I) the Corporation [or other persons] to whom such conveyance is made assumes all of the obligations under any applicable conditional sale agreement, equipment trust agreement, or lease with respect to such rolling stock (including any obligations which accrued prior to the date on which such properties are conveyed). . . .

The Government parties contend that the transferors received OB to the extent that the liquidation value of rolling stock transferred under the Act was less than the assumed obligations upon it that would have been reached in the respective bankruptcy proceedings.

As compared with these two items, the Statement lists, without limitation, five other items which the Government parties would claim as VOB if any part of the rail properties of a transferor were to be valued under a scenario providing for continued rail use in the absence of the Rail Act: (1) expedition of and exemptions from regulatory action; (2) avoidance of operating costs after April 1, 1976; (3) avoidance of executory contracts and inchoate obligations; (4) avoidance of labor protection costs; (5) and avoidance of loss on retained properties to the extent that the FSP provided more rail service than an alternative scenario would have done.[63] All these claims are hotly disputed by the transferors.

63. The Government parties recognize that some of these items might be taken as deductions in the alternative scenario itself; to that extent, of course, they should not be counted again as OB.

The briefs have also flushed out a legal point that had escaped our attention. Section 303(c)(1)(A)(i) directs us to decide whether the transfers or conveyances to ConRail "in exchange for the securities, certificates of value and the other benefits accruing to such railroad as a result of such exchange" are fair and equitable; § 303(c)(1)(A)(ii) directs us to decide whether the transfers or conveyances to profitable railroads, States or responsible persons "in exchange for compensation and other benefits accruing to such transferor as a result of such exchange" are fair and equitable.[64] On the other hand, § 306(c)(4) provides that determination of the base value of the CV's involves

> subtracting the value of other benefits provided under this Act, as determined by the special court. . . .

Most of the transferors contend that the omission of the "as a result of such exchange" language in § 306(c)(4) was simply permissible Congressional shorthand and does not indicate any intention that we should determine VOB on any more enlarged basis under § 306(c)(4) than under §§ 303(c)(1)(A)(i) and (ii). We do not understand that the Government parties seriously dispute this. We hold the meaning to be the same;[65] when Congress in § 306(c)(4) used the phrase "as determined by the special court," it referred to the determination we had been directed to make under §§ 303(c)(1)(A)(i) and (ii). The omission of the phrase "as a result of such exchange" will therefore not be considered significant.

There is less agreement over the effect of that qualifying phrase. However, it would be wasteful to review the somewhat

64. The "as a result" language was contained in § 303(c)(1)(A)(i) of the Act as enacted in 1974. The 1976 amendment added to both subsections: "(taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad during the bankruptcy proceeding with respect to such railroad)."

65. The NH Trustee suggests that the language of § 303(c)(4) may be *more* restrictive because of its use of the words "provided under this Act." Brief at 5 n.7. We reject this suggestion.

abstruse arguments that have been presented on that issue until we know just what OB are claimed and allowed. And this, as almost all parties agree, will depend on both the theory of value and the specific hypothetical dispositions of rail property put forward by the transferors. We have therefore concluded that it would be unprofitable for us to endeavor further to clarify the subject of VOB at the present time.

IX. *Conclusion*

As we review this opinion, we must confess some disappointment at the rather meager results which the extensive briefs and arguments of able counsel and our intensive consideration of them have produced. However, our malaise goes deeper. Even on the chart we have drawn for the future course of these proceedings, a chart which the transferors will doubtless claim to have wrongly precluded many lines of pertinent proof, the parties and this court seem doomed to spend years in an enterprise as unsatisfying as it will be interminable. We are to endeavor to fix the values of these enormous properties by estimating what the transferors could have realized by engaging in one course of action—ceasing operation and selling all of the property as scrap—that was never seriously considered by anyone, or another—an endeavor by each of the transferors to find a buyer or buyers for parts or all of its lines and selling the rest for scrap—that was not explored because it had become evident early in 1973 that something like the Rail Act would be adopted. Although the estimation of scrap value would not be simple, the problems inherent in determining value for railroad use are staggering. Even if we should take the easiest assumption—one which the transferors may not adopt and which the Government parties will doubtless contest—namely, that the transferors would have acted as a group and dealt with the western and southern railroads as a group, and then determined what lines would have been purchased, we would next have to determine what the buyers

would have paid.[66] We can assume that the transferors would not have sold for less than scrap value and that the buyers would not have paid more than a capitalization of the losses they would have suffered from cessation of service by the sellers = the income (or deficit) from the properties bought. But where would the bargain have been struck? As said in the opening brief of the New Haven Trustee (p. 67), "it is impossible to refine the model to such a degree that a price, or formula for such a price, can be determined precisely, or even to predict the particular bargaining strategy each would adopt"; the Trustee believes the price most likely to be reached would fall in the band between the arithmetic and geometric[67] means of the original offers (p. 72). However this may be as to the entire universe of sales, there is no assurance that it would be true in the particular instance before us; common experience tells us that a negotiator will often adhere rather closely to his starting position if he feels confident of his superior bargaining power. Further guessing would be needed as to how the price should be allocated. To take just one example of the difficulties, a transferor whose line was not included in the hypothetical purchase might claim some share on the basis that the disappearance of its line enhanced the desirability of those that were continued: indeed, the transferors would very likely insist on some provision to deal with this contingency before joining the selling group.[68]

66. The Government may also be expected to argue that even a consortium of buyers would not have had the resources needed to rehabilitate the purchased properties.

67. The geometric mean is the square root of the product of the two starting prices.

68. *See Cross, The Economics of Bargaining* 42-90 (1968), for a discussion of other factors that would affect the outcome of the bargaining process.

Economists, as a rule, are not so sanguine as the New Haven Trustee about their ability to determine where the bargain will be struck between the parties' bargaining limits. *See, e.g., Ferguson, Microeconomic Theory* 281-82 (rev. ed. 1969); *Henderson & Quandt, Microeconomic Theory* 247 (2d ed. 1971); *Shows & Burton, Microeconomics* 475 (1972); *Cohen & Cyert, Theory of the Firm: Resource Allocation in a Market Economy* 278-81 (2d ed. 1975).

We do not believe that Congress expected that this court would have to engage in such a prodigious and time-consuming effort in conjecture. As indicated earlier in this opinion, we fear that when Congress adopted the Rail Act it had a false security with respect to the relative ease of our determining the values here at issue, supposing that this would follow the model used in the New Haven inclusion in Penn Central. Indeed the FSP so declares. Vol. I, at 124.[69] Even that valuation had taken three and a half years for a much smaller property, but it was doubtless thought that more manpower could be deployed and that there would not be the same shuttling between the Interstate Commerce Commission and the courts. Little or no consideration seems to have been given by Congress to the complications arising from the fact that, whereas the hypothetical NH liquidation involved a single seller, the one here at issue would involve many. It is even clearer that Congress acted upon this expectation of a relatively speedy solution when it adopted the amended Act in 1976, with the FSP and its description of the MLP before it, *see* Vol. I, at 124-28, and with the need for taking account of possible sales for railroad use dismissed on the easy basis that "the prices for such sales would be regulated and fixed at the pricing levels which would obtain if all rail operations over the lines of the bankrupts actually ceased and as if the assets of the railroads in reorganization actually were dismantled and disposed of for other uses," Vol. I, p. 125, an assumption which was unexplained and in our view, unsound, *see* pp. 31-32, *supra*.

Our discussion in Part IV should have made two things very clear. One is that we will not value these properties on the basis of or even "consider" such fantasies of "experts" as RCNLD, trended OCLD, social value, etc., that would provide a bonanza to investors beyond anything of which they could have justly dreamed in the dark days of 1973. The nation's need for rail

69. These statements are not contrary to our ruling that the Rail Act cannot properly be read as *prescribing* that method of valuation. We are here stating only what we think Congress expected, not what it prescribed or what the Fifth Amendment demands.

service affords no basis for the award as just compensation of "values" which these properties have not possessed for years and which their owners could never have realized except through condemnation by the Federal Government. The other is that we will not limit just compensation to provable market values if the transferors, through no fault of their own, cannot prove market value with sufficient nicety. We again remind the parties of the wisdom of Mr. Justice Black that "when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public, courts have fashioned and applied other standards," *United States* v. *Commodities Trading Corp., supra,* 339 U.S. at 123. We have mentioned as one other standard that may be found worthy of consideration original cost subject to appropriate deductions—a figure which can be ascertained, with relative ease and without much guesswork, from records whose maintenance has long been required by law. We invite the parties to consider whether their interests might not be better served by endeavoring to reach agreement on a figure that can be so derived rather than by asking this court and ultimately the Supreme Court to seek a resolution, necessarily unsatisfactory to some and perhaps to all, among the conflicting opinions of experts as to what could have been obtained by way of sales, with the attendant lapse of years and the incurring of enormous expense. We do not mean to limit such consideration by the parties to original cost with appropriate deductions—perhaps there is some better way. But we would be remiss if we did not advise the parties and also the lawmakers of our fears as to the length and cost of these proceedings if they are carried to a conclusion under the charter that has been given us, even with the simplifying limitations we have here imposed. Nearly four years have elapsed since the Rail Act was adopted and a year and a half have gone by since the conveyances. Yet despite earnest and sincere efforts by all concerned, we are only at the start of the valuation problem.

The parties are directed to proceed in the manner directed in this opinion. If the Acting Liaison Committee believes a conference between it and the Court would be desirable, we shall be glad to meet with them.

APPENDIX F

Appendix F

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed October 31, 1977, James F. Davey, Clerk

Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT.

Order Postponing Effectiveness of Order of Denial of July 5, 1977

Upon consideration that—

a. on July 5, 1977, in its opinion On Motions for Reconsideration of Opinion of April 19, 1977, on Compensable Unconstitutional Erosion (CUE), this court postponed the effective date of its order of denial until November 1, 1977; and

b. on October 25, 1977, the Trustees of the Property of Penn Central Transportation Company, Debtor, and certain affiliated Penn Central Transferors filed a motion for reconsideration of the Special Court's decision of October 12, 1977, which has been joined by several other parties; and

c. on October 28, 1977, the Trustees of the Property of Penn Central Transportation Company, debtor, and certain affiliated Penn Central Transferors filed a motion to postpone the effectiveness of this court's order of denial of July 5, 1977; and the court has been informed that the Government Parties do not object to the granting of the requested postponement,

Appendix F

IT IS ORDERED that the court's opinion of July 5, 1977, is modified to postpone the effectiveness of the order of denial until such date as the court disposes of motions for reconsideration of the October 12, 1977, opinion.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

October 31, 1977

APPENDIX G

Appendix G

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed November 18, 1977, James F. Davey, Clerk

Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

On Motions for Reconsideration of Opinion of October 12, 1977

The Trustees of the Property of Penn Central Transportation Company and certain affiliated transferors (hereinafter the movants) having moved for reconsideration of this court's decision of October 12, 1977 (the decision), which motion has been joined by the Intervening Penn Central Lienholders; the Trustees of Erie-Lackawanna Railway Company and certain affiliated non-bankrupts; the Trustee of the Lehigh Valley Railroad Company; North Pennsylvania Railroad Company, Delaware and Bound Brook Railroad Company, Philadelphia, Germantown and Norristown Railroad Company, Plymouth Railroad Company (the NBIO's); the Peoria and Eastern Railway (P&E); and others, it is ordered as follows:

1. The movants' first ground for reconsideration is that this court should make clear that the holding on pp. 17-18 of the decision that the method prescribed in § 306(c)(5) for determining the value of ConRail securities would pass constitutional

muster in the sense that such securities might be used as part of the payment for the transferred properties, was not intended to preclude the transferors from contending that the particular method of valuing the ConRail securities was so unfair as to be unconstitutional. We agree; we will arrange for this to be taken up at a more appropriate time.

2. The movants' second ground is that this court "should make clear that no ruling has been made concerning the types of evidence relevant to show what buyers other than the Federal Government would have paid for the transferors' properties absent the Rail Act." (Motion p. 9) More specifically the movants ask us to say that our rejection of the reproduction cost and other types of evidence discussed at pp. 77-89 was confined to a hypothetical sale to the federal government, to which the reified property concept urged by some transferors should clearly be added, and would not preclude the offer of such evidence, notably real estate assemblage costs, if relevant to show "that, absent the Rail Act a particular corridor would have been sold to a private buyer who needed to acquire such a right-of-way and would otherwise have to assemble real estate parcels into a continuous corridor." (Motion, p. 8)

Our discussion was not intended to be as limited as the movants suggest. We had already rejected inclusion of the United States in the market (pp. 42-43) and the reified property concept (pp. 36-37) on other grounds. The principal purpose of our discussion on pp. 77-89 was to relieve the transferors of the expense of preparing and this court of the burden of hearing and passing upon studies of reproduction cost, etc., tendered on the basis that we might turn to such methods of valuation if efforts to establish market value proved unsuccessful. Although our discussion did not focus specifically on the possible relevance of such evidence to the price that would have been paid by profitable railroads or by public bodies other than the Federal Government, we think the

instances where such evidence would have even minimal relevance, if existing at all, would be exceedingly rare. It is hard for us to understand why profitable railroads would have paid more than "a capitalization of the losses they would have suffered from cessation of service by the sellers ± the income (or deficit) from the properties bought," which we considered to be the upper limit of the bargaining range (p. 104), simply because it would cost more to reproduce the property. It is equally hard for us to visualize public bodies taking into account such values as "assemblage costs," and the inclusion of any such items would acutely raise the question discussed on pp. 96-97 of the decision. Hence, while the movants may be literally correct in saying (Motion, p. 8) that we did not mean "to exclude all such forms of evidence in all circumstances" (save for the principle of *Foley Square*), our instructions to the masters, while taking account of the considerations now urged, will permit receipt of evidence on valuation theories generally rejected in pp. 77-89 of the decision only on a preliminary showing that particular prospective buyers would in fact have given weight to them — and perhaps only after submission of the question to the court. In sum, by agreeing with the movants to the exceedingly limited extent here indicated, we do not mean to allow quantities of evidence of reproduction cost, etc., to enter by the back door.

3. The movants ask us to reconsider our discussion (pp. 58-64) of decisions of the Court of Claims relating to the Government's use of patents. We find no reason to do so.

The additional point raised by the NBIO's does not persuade us to modify our holding on pp. 13-18 except as stated in item one above. We make the same ruling with respect to the P&E. If, as alleged in its statement of additional grounds for reconsideration, a 1972 study showed that major portions of its lines "could feasibly be sold or leased to other profitable rail lines", P&E should be able to establish a market value that will reflect this. We still

hold that CV's and ConRail securities, properly valued, may be used to pay part or all of this.

We have already taken action, in accordance with movant's request, to postpone the effectiveness of our CUE decision until the entry of this order.

Except as heretofore stated, the motions for reconsideration are denied.

HENRY J. FRIENDLY
Presiding Judge

JOHN MINOR WISDON
Judge

ROSZEL C. THOMSEN
Judge

November 18, 1977

APPENDIX H

Appendix H

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed November 24, 1981, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Opinion With Respect to Valuation for Rail Use

WILLIAM C. LIEBLICH, Washington, D.C. and THOMAS R. RADOM, Southfield, Mich. (Thomas S. Warrick and Pierson, Semmes, Crolius & Finley, Washington, D.C.; David W. Berry, and Joseph S. Radom, P.C., Southfield, Mich., of Counsel), for Trustee of the Ann Arbor Railroad Company.

STANLEY WEISS, Newark, N.J. (Dean R. May and Carpenter, Bennett & Morrissey, Newark, N.J., of Counsel), for Central Jersey Industries, Inc.

John N. Malyska, Newark, N.J., for Delaware and Bound Brook Railroad Company.

HARRY G. SILLECK, JR., JOHN L. ALTIERI, JR., and HOWARD W. GOLDSTEIN, New York, N.Y. (Peter W. Asher, Thomas G. Gallatin, Jr., Jack P. Adler, Harold G. Levison, Susan M. Schmedes, Frances E. Edwards, Douglas M. Parker, Frank T. Laznovsky, Robert A. Jaffe, Karen M. Cullen, Robert A. Cantor, and Mudge, Rose, Guthrie & Alexander, New York, N.Y.,

of Counsel), for Trustees of the Erie Lackawanna Railway Company.

JOHN MICHAEL CLEAR, St. Louis, Mo. (Stuart R. Warren and Bryan, Cave, McPheeters, & McRoberts, St. Louis, Mo.; Harry G. Silleck, Jr., Peter W. Asher, John L. Altieri, Jr., and Mudge, Rose, Guthrie & Alexander, New York, N.Y.; David C. Toomey, Jared I. Roberts, Robert C. Unger, Jr., Lewis R. Olshin, and Duane, Morris & Heckscher, Philadelphia, Pa.; Howard H. Lewis, James A. Sox, and Obermayer, Rebmann, Maxwell & Hippel, Philadelphia, Pa.; John Vanderstar, S. William Livingston, Jr., Carolyn F. Corwin, Arvid E. Roach II, and Covington & Burling, Washington, D.C., of Counsel), for Joint Terminals Transferors.

DAVID C. TOOMEY, Philadelphia, Pa. (Jared I. Roberts, Richard C. Unger, Jr., Lewis R. Olshin, and Duane, Morris & Heckscher, Philadelphia, Pa., of Counsel), for Trustee of the Lehigh Valley Railroad Company.

Thomas E. Tyre, New York, N.Y., for North Pennsylvania Railroad Company.

CHARLES I. THOMPSON, JR., Philadelphia, Pa., for Philadelphia, Germantown & Norristown Railroad Company.

HOWARD H. LEWIS, Philadelphia, Pa. (James A. Sox, Richard W. Vitaris, Robert F. Stewart, Jr., and John F. Ehlinger, Jr., and Obermayer, Rebmann, Maxwell & Hippel, Philadelphia, Pa., of Counsel), for Reading Company and Certain Affilialted Transferors.

WILLIAM R. PERLIK, MICHAEL S. HELFER, ROGER M. WITTEN, DAVID R. JOHNSON, ERIC A. VON SALZEN, and STEPHEN C. ROGERS, Washington, D.C. (Peter F. Rousselot, Robert H. Kapp, Joe Chartoff, George W. Miller, Gail Starling Marshall, George W. Mayo, Jr., Walter A. Smith, Jr., V. Mark J. Policy, William J. Cassidy, Jr., Ronald E. Stauffer,

Cathy A. Simon, Wallace A. Christensen, Stephen A. Goldberg, David C. Kohler, Karen L. McClearycale, Ann Morgan Vickery, Kevin J. Wolff, George H. Mernick, III, Paul W. Nolan, Steven B. Rotman, R. Verne Bradford, and Hogan & Hartson, Washington, D.C.; Henry T. Rathbun, Arthur Z. Gardiner, Jr., A. Douglas Melamed, Richard W. Cass, David M. Becker, William J. Perlstein, Stephen P. Doyle, John B. McNeece, III, Maury J. Mechanick, Bruce E. Coolidge, Marie N. Doland, Lauren B. Homer, Sheila Bihary, Joan S. Powers, Judith Barry Wish, and Wilmer, Cutler & Pickering, Washington, D.C.; Cary W. Dickieson, Frazer C. Hilder, David H. Siehl, David L. Prestemon Barbara E. Sosnick, Larry C. Malski, Jonathan E. Pansius, and Mark H. Sidman, United States Railway Association, Washington, D.C., of Counsel), for United States Railway Association.

Alice Daniel, Asst. Atty. Gen., John H. Broadley, Thomas S. Martin, and Jane A. Restani, Department of Justice, Washington, D.C., for United States of America.

Appendix H

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Appendix H

PER CURIAM:

We here set forth such conclusions as we have been able to reach with respect to the value the transferors (Ts) which have not settled their cases could have obtained for properties that would have continued in rail use. We state the scope of this long opinion thus modestly because of several factors that could not have been anticipated when our *CMV Opinion,* 445 F.Supp. 994 (1977), and our initial pre-trial orders were issued.

During the course of the proceedings, although after the evidentiary hearings were concluded, Penn Central (PC), the largest T, representing some 80% of the case in terms of property value, settled with the Government Parties (GPs)—the United States and the United States Railway Association (USRA). This was quickly followed by settlements on the part of several small Ts—the Lehigh & Hudson, the New York & Long Branch, the Pennsylvania-Reading Seashore Lines, and the Dayton Union. After the case had been briefed and argued and this opinion had been partially drafted, another important T, Reading (R) and its subsidiaries, also settled. Shortly thereafter, the independent owners of rail property operated by R, the Philadelphia, Germantown & Norristown, the Delaware & Bound Brook, and the North Pennsylvania, reached settlements with the GPs. Then the Niagara Junction Railroad, jointly owned by PC, Lehigh Valley (LV), and Erie Lackawanna (EL); the Kalamazoo, Allegan & Grand Rapids Railroad, and independent line leased by PC; and the Norwich & Worcester agreed in principle to a settlement of each of their claims with the GPs. This left EL, LV, Central Railroad of New Jersey (CNJ), Ann Arbor (AA), and Lehigh & New England (L&NE) as the only Ts whose claims are still at issue.

When this opinion had been substantially completed, save only for minor textual revision, final checking, and typing, EL and

the GPs, on October 22, 1981, filed a motion for an order suspending litigation activities between them. The motion stated that on October 19 negotiators for the United States, USRA, and the El Trustees had reached an agreement for a settlement subject to necessary approvals of their principals. Government counsel explained, at a conference with the Presiding Judge of this Court, that the obtaining of all necessary Government approvals might take several weeks. Upon these being obtained, the EL Trustees and the GPs proposed to submit the settlement agreement to us for approval. An order to show cause why the order suspending litigation should not be entered was issued on October 22, 1981, Sp. Ct. Rep. N 37875; no objections having been filed, the order was entered. On November 17, 1981, the GPs and the EL Trustees petitioned for approval of the settlement, and this court has entered an order to show cause specifying the procedure for intervention and the filing of objections, and setting a hearing for January 25, 1982.

As pointed out in a memorandum accompanying the motion to suspend litigation, our hearing on the approval of the settlement must take account of Order No. 1094 of the District Court for the Northern District of Ohio in the EL reorganization proceedings. In this order, dated September 9, 1981, Judge Krupansky, the reorganization judge, authorized the EL Trustees to enter into a settlement agreement with the GPs subject to our approval and without the necessity of further proceedings in the reorganization court respecting the terms of the settlement. This authorization was conditioned on the Trustees' giving "reasonable notice to all parties customarily notified in these [reorganization] proceedings of any hearing before the special Court concerning approval of such settlement agreements and shall support any such party's

right to be heard by the Special Court concerning any such settlement agreement". In the event that any party to the reorganization proceeding filed a timely petition to intervene in this court and we did not permit it to intervene and be heard, the authority granted the Trustees by Order No. 1094 was made subject to further order of the reorganization court at which such party would be given an opportunity to be heard. Our order to show cause with respect to the settlement takes account of Judge Kurpansky's Order No. 1094.

We have concluded that, despite these developments, we should not defer the filing of this opinion until after the approval hearings on the EL settlement have been concluded. As will appear hereafter, we cannot and do not here arrive at the figure which, in our view, EL would have obtained in these proceedings; the greatest unknown and at present unknowable is the value of the passenger lines in Northern New Jersey which we conclude that the State would have purchased despite their negative earnings value. Release of the opinion in advance of the settlement approval hearing should assist the parties to the reorganization proceeding and ourselves in appraising the fairness of the settlement without, however, precluding its approval as an opinion setting total value might have done. We say "might" since even if we had arrived at a total figure higher then the value of the settlement (including the significant benefit to EL of receiving the proceeds now rather than on December 31, 1987, see Rail Act § 306(c)(1)), account would have had to be taken of the possibility of disagreement by the Supreme Court with some or even all of our conclusions that are favorable to EL. Moreover, we think justice requires that the railroads that have not settled should be advised of our conclusions as soon as we are ready to announce them, both because the scheduling of the nonrail use phase of the case is geared to such announcement, Sixth Pre-Trial Order, ¶7, Sp. Ct. Rep. at N

35967, and because the announcement may facilitate settlement by them. When EL and the GPs have deferred their settlement so long, we perceive no obligation on our part completely to rewrite the opinion at this late date so as to eliminate the lengthy discussion of EL's case, with the possibility of having to restore this if the settlement should be disapproved.

One major obstacle has prevented our accomplishing as much as we had hoped in this opinion. In a good many instances Ts have argued that rail use properties would have been sold at a price equal to or at a premium above their value for nonrail use. Analysis has made clear that the parties entertain widely different views as to what nonrail use value is and, for reasons developed in Part III of this opinion, the determination of that Issue must await the nonrail use phase of the case, although we do here rule on whether premiums would have been paid or deductions made.

While, as we recognized long ago, *CMV Opinion,* 445 F.Supp, at 1044, no amount of evidence, argument, deliberation and study can produce a single demonstrably right figure, we had hoped to be able to produce in this phase of the case definite figures of value for rail use. Although we have not been able fully to achieve this goal, we have been able to decide a large number of issues, to set forth the general method we intend to pursue in completing our work, and to focus the parties' attention on certain problems that must be dealt with in the ensuing phase of the case dealing with nonrail use value. Conceivably, this may cause the remaining parties and the GPs to do what we recommended over four years ago, *CMV Opinion,* 445 F.Supp. at 1045-46, and what finally was done in the cases of PC, R, and EL as well as those of smaller railroads, namely, to arrive at reasonable settlements.

We shall begin our opinion with two expository sections, Part I recounting the procedural history of the case since the *CMV Opinion* and Part II summarizing the positions of the parties.

Appendix H

Part III contains a legal analysis of certain problems, particularly as to what we may or may not properly now decide, that have surfaced during the presentation of this phase of the case. This is followed by six parts dealing with "cut-across" issues relating to claims for values based on earnings power, to wit, the claims of the GPs that the Ts' assertion of earning power should be rejected out of hand because of the allegedly hopeless conflict between them and the history that led to enactment of the Rail Act (Part IV); the nature and effect of bargaining (Part V); the GPs' claim that purchasers would have sharply reduced the Ts' estimates of future earnings because of inflation (Part VI); the method for translating estimated future earnings into earnings value (Part VII); the deductions that a purchase would have made because of the need to rehabilitate and maintain the properties (Part VIII); the deductions that a purchaser would have made to reflect the cost of labor protection conditions (Part IX); and the timing of projected sales and the conditions, if any, that the Interstate Commerce Commission (ICC) would have affixed (Part X). In Part XI we deal with a number of vexing issues concerning proposed acquisitions by public bodies. Part XII Is devoted to problems not theretofore considered relating to the sales for earnings value proposed by EL, LV, AA, and L&NE. Finally, in Part XIII, we deal with special contentions made by CNJ.

I. Procedural History

The *CMV Opinion*, 445 F.Supp. at 1009, set out a schedule designed to initiate a phase of the case intended to determine values the Ts could have obtained for their properties for continued rail use in the absence of the Rail Act. Each T claiming values from sales for rail use was required to exchange its proposal with all other Ts by January 9, 1978, so that they could meet among themselves to facilitate resolution of inconsistencies and deliver their resulting proffers to the GPs by March 9, 1978. The

GPs were given 30 days to indicate objections relating to inconsistencies and the Ts were to file their finally revised proffers with the court within 30 days after receiving the objections.

The First Pre-Trial Order, dated April 18, 1978, Sp. Ct. Rep. N 10078, further required that each T specify the principal rail use issues it believed had to be tried, along with a description of the evidence it intended to offer to demonstrate what it would have been able to realize for transferred properties in the absence of the Rail Act. This information and other reports from the parties provided the basis for a pre-trial conference on June 21-22, 1978, that led to the Second Pre-Trial Order, dated June 23, 1978, Sp. Ct. Rep. N 11796. It established a schedule for the submission of direct evidence by the Ts, and by the GPs on "affirmative defenses".[1] The latter issues included, among others, the cost of rehabilitating the properties proposed for transfer, the abilities of private purchasers and public agencies to finance the transfers, and the impact of labor protection obligations upon the values the Ts would have received for their properties. Most importantly, all direct evidence was ordered to be presented in writing.[2] The court rejected the proposals of various Ts that there be separate trials on separate issues because a single trial encompassing all rail use issues was believed conducive to more rapid progress. We also directed each T to submit its direct rail use case in such form as would permit us to make necessary adjustments where we found some but not all of a T's contentions persuasive. The significance of this order and the failure, perhaps in part inevitable, fully to comply with it, will become apparent in later parts of this opinion. Finally, as developed in Part III, preparation for trial of issues related to the values of the Ts' properties in nonrail use was deferred.

The Ts each submitted their direct evidence, accompanied by a memorandum summarizing the submission, in December 1978; the GPs' submission arrived as scheduled on January 31, 1979. The Third Pre-Trial Order, dated January 11, 1979, Sp. Ct. Rep. N 15287, provided that the parties should conduct discovery and

cross-examination by means of the deposition process, with discovery to be conducted by the exchange of information outside of the formal discovery process to the fullest extent practicable. One result of the dual requirement that all testimony be in writing and cross-examination be by deposition was to avoid what had been expected to be the need for a multitude of special masters in this phase of the case. This also permitted the parties to make their own agreements on how the discovery and cross-examination process should be handled and to conduct as many as a half-dozen cross-examinations simultaneously. The remainder of the order limited the number of depositions to which each witness could be subjected, provided that depositions may be offered for admission as testimony, and established procedures for the expeditious processing of objections.[3]

The Fourth Pre-Trial Order, dated May 16, 1979, Sp. Ct. Rep. N 17130, effected a more precise division between the rail and nonrail use phases of the case. We granted a motion of the GPs to defer consideration of evidence of nonrail use values or of appraisal methodologies for determining nonrail use values of any properties. However, evidence indicating that certain lines would have been kept in rail use for reasons other than their earnings power as well as evidence that purchasers of lines sold for rail use would have paid prices based in whole or in part with reference to nonrail use values was to be included in the rail use phase of the proceedings. All parties were directed to begin preparation of their nonrail use evidence at this time, although our consideration of that evidence was to be delayed until after this decision.

The Fourth Pre-Trial Order also directed the GPs to file their remaining evidence on rail use issues by November 1, 1979. This demand was less than successful; on October 23, 1979, the GPs filed a motion for a 90-day extension of time, Sp. Ct. Rep. N 18191, which was opposed by the Ts. The court could discern no adequate basis for the GPs' waiting until October 23 to call the problem to the court's attention, and also considered there was no

justification for the requested delay. Yet the public interest in fully developing the facts in this litigation required granting the motion of the GPs.

The Fifth Pre-Trial Order, dated March 27, 1980, Sp. Ct. Rep. N 19675, scheduled rebuttal evidence and started the briefing schedule. The Ts were givens until October 10, 1980, to file any additional rail use evidence by way of rebuttal. The GPs were ordered to file their schedule of depositions with respect to the Ts' rebuttal evidence by November 10, 1980. On October 24, 1980, the GPs moved to strike a substantial portion of the Ts' rebuttal evidence as not constituting proper rebuttal, Sp. Ct. Rep. N 22028. This motion was granted in part; we struck witnesses' repetition of initial testimony and other evidence that could and should have been presented years before, Sp. Ct. Rep. N 22621.

In the interest of expedition we ordered two simultaneous exchanges of briefs rather than sequential filings. The initial briefs were prepared on the basis of the Ts' and GPs' direct rail use cases, thus avoiding the delay that would have resulted from awaiting completion of the taking or rebuttal evidence. On May 8, 1980, in a separate order, Sp. Ct. Rep. N 20410, we denied the Ts' request that the initial briefs be accompanied by separate proposed findings of fact and conclusions of law to which opposing parties must respond. Initial briefs were scheduled to be due by December 2, 1980. Both sides were ordered to include in their briefs discussion of evidence developed by the opposing parties in their direct cases. Given the many statements of position and extensive testimony, each party was sufficiently aware of its opponents' cases to permit effective coverage in the initial brief subject to only minor supplementation later. The parties were also directed to include in their briefs the extent to which any claims of value to one T depended upon particular outcomes for other Ts.

The proceedings in this case were briefly interrupted when PC and its affiliated Ts, including the New York & Long Branch, 50 percent of which was owned by CNJ, and GPs entered into a

settlement agreement on November 16, 1980.[4] The net liquidation value of all rail properties transferred and conveyed by PC and its affiliated Ts was stipulated to be $1.46 billion. The parties further stipulated the value of other benefits and compensable unconstitutional erosion (CUE), see *CUE Opinion*, 439 F.Supp. 1351, 1355 (1977), applicable to PC and its affiliated Ts to be zero. Each group of settling parties released essentially all its claims arising under the Rail Act against the other. The agreement provided that the Conrail securities, stipulated to have been without fair market value, to be received by the PC and its affiliated Ts were to be assigned to USRA. PC and its affiliated Ts thus received Certificates of Value with April 1, 1976, principal amounts equal to the stipulated net liquidation value, which were to be redeemed immediately. One frivolous objection was filed in response to the court's November 17, 1980, order to show cause why the agreement should not be approved; after hearing, the objection was promptly overruled, and the settlement was approved on December 5, 1980, Sp. Ct. Rep. N 23314.[5]

This settlement, and the consequent disappearance of PC as a litigant which had taken the lead role for the Ts, complicated the task of the parties in preparing their opening briefs. In our separate December 5, 1980, order, Sp. Ct. Rep. N 23420, we therefore extended the date for filing initial briefs until January 12, 1981, and fixed April 20, 1981, as the date for reply briefs. The GPs' opening brief included 9 volumes of argument totaling almost 5,000 pages, 49 maps, and a 32 volume supplemental appendix. The bankrupt Ts still in the case submitted 12 volumes of briefs accompanied by 52 volumes of appendices, in addition to various other submissions.

Upon motion of the Ts, our March 24, 1981, order extended the due date for reply briefs until May 5, 1981. This time the GPs limited themselves to only 3 volumes and each T submitted only one, in addition to some additional volumes of appendices.

Oral argument was set for June 8-10, 1981. We heard for a day each from the Ts and GPs, with the former presenting rebuttal argument on June 10, followed by a few brief comments from the GPs. Prior to the argument, we had indicated to the parties a number of issues upon which they should comment at argument. In addition, the court in constructing this opinion has had the benefit of written clarifications and elaborations of the parties' arguments and positions which it has requested, in each case affording opposing parties an opportunity to respond.

On August 5, 1981, when considerable progress on the writing of this opinion had been made, the court received a petition of the GPs and the Reading Company, which had succeeded to the interest of the reorganization trustees of R, for approval of a settlement, Sp. Ct. Rep. N 36420. The agreement, which followed the general format of the PC settlement so far as practicable, settled the claims of R and five other companies for which it was (or expected soon to be) in a position to speak. The settlement for R and those five companies was for a base value of $87,497,489. With respect to several other lines which had not become bankrupts and in which R did not own a majority of the stock, the so-called NBIO's (non-bankrupt independent operators), the settlement contained a table of "Statutory Values", aggregating $33,475,095. These were sums at which the GPs were prepared to settle with each of these Ts. The Reading Company agreed to indemnify the GPs, subject to certain conditions, against any recovery by an NBIO in excess of its stipulated statutory value.

A hearing with respect to approval of the settlement was had on September 2, 1981. Objection was made by North Pennsylvania Railroad Company (North Penn), the largest of the NBIO's, for which the settlement established a statutory value of $21,593,547. North Penn did not attack the reasonableness of the $120,973,484 fixed as the base value for the entire Reading System but sought an evidentiary hearing to determine a "fair and proper allocation" of that sum to North Penn. Concluding

that North Penn had no right to such a hearing since it was left free to prosecute its own claim against the GPs, we entered orders approving the settlement and making certain provisions with respect to North Penn's prosecution of its claim, Sp. Ct. Rep. N 36847. Later North Penn decided to join the other NBIO's in entering into settlement agreements similar to R's at the "Statutory Values" set forth in the R agreement. No objection was made to these settlements.[6]

II. Position of the Parties

Given the dependence of each T's prospects upon what would have become of other Ts in the absence of the Rail Act, as well as the substantial overlap of issues across the claims of various Ts, it is useful to present at the outset a summary of the major contentions of the parties. In this portion of the opinion we make no attempt at completeness and express no judgment on the merits.

A. *Joint Terminals*

Four Ts (PC, EL, R, and LV) developed a proposal, not envisioned in our earlier consideration of the case, that freight properties within what are described as the Philadelphia and Northern New Jersey/New York terminal areas would have been purchased and consolidated by public bodies in the absence of the Rail Act.[7] Public bodies allegedly would have been motivated by the necessity of keeping the freight terminals in operation and the desirability of rationalizing the freight transportation system through elimination of duplicative and obsolete facilities and coordination to reduce the facilities necessary to perform terminal services, and to enhance integration of freight operations with commuter and passenger services.

These Joint Terminals (JTs) would have handled the switching, origination, and termination of all freight traffic within the area, interchanged cars delivered by main line trains, and provided service within the terminal areas, including service to and

from the New York/New Jersey and Philadelphia ports. The Northern New Jersey/New York terminal (NJ/NYTerm) properties were located in New Jersey, and concentrated along the Hudson River and New York Harbor, but extended north as far as commuter service or the New York state line, west to the Pennsylvania state line, and south to the Raritan River, and also included lines going beyond that to Trenton, West Trenton, and Bay Head, New Jersey. The Philadelphia terminal (Philaterm) included PC's and R's freight properties in the Philadelphia area up to the Delaware and New Jersey state lines and extended west in Pennsylvania as far as the limits of the electrified commuter network. Both terminals had some operating responsibility beyond these boundaries.

Under this scenario, the Joint Terminals Ts (JTTs) thought that public bodies would have purchased terminal freight properties for salvage value, with terminal operating costs to be recouped through switching charges covering the costs (other than capital costs) of services actually performed. Those JTTs with commuter lines argue in their individual cases that public bodies, not necessarily the same ones as those purchasing the JTs properties, would have acquired commuter and intercity passenger lines in the area at premiums in excess of nonrail use value. Both the GPs and the JTTs conducted JTs studies to determine how high the switching charges would have had to be to operate the terminals on a break-even basis. The requisite switching charges calculated by the GPs are on the order of twice those presented by the JTTs.

B. *Penn Central*

Although PC is no longer in the case, it is still necessary to understand its proffers since the probable dispositions and earnings values of other Ts' lines are to some extent dependent upon what would have become of parts of PC. PC contended that its high-density freight lines that connected major metropolitan

areas and provided interchanges with Western and Southern railroads would have been acquired by profitable railroads. Eight Intercity Freight Lines (IFLs) were to comprise this network: four major east-west routes—Chicago to New York (via Cleveland and Buffalo), Chicago to Pittsburgh, St. Louis to Cleveland, and St. Louis to Pittsburgh and Harrisburg with an extension to Perryville, Maryland, where it would join the "spine" of the Northeast Corridor[8]—and four shorter routes—Chicago to Detroit, Chicago to Cincinnati, Detroit to Cincinnati, and Youngstown to Ashtabula.[9] Individual Western and Southern railroads were identified as the most likely acquirers, each motivated by the fear of losing traffic if the IFLs were abandoned or purchased by competitors. Projections were also made for the possible acquisition of all the IFLs by a consortium of the Western and Southern railroads, as well as for purchase by the profitable Eastern railroads—Chessie and Norfolk & Western.

PC contended that its Northeast Corridor properties would have been acquired by public bodies for continued rail use absent the Rail Act. Amtrak was identified as a likely buyer for the spine, the main line of the Northeast Corridor running between Boston and Washington, D.C. State, regional, and local bodies would supposedly have acquired commuter lines connecting to the spine, and, if the negotiations already begun with Amtrak did not come to fruition, portions of the spine as well. One aspect of PC's valuation case was that an acquisition agreement for the spine would have included free trackage rights for PC's freight traffic. Other Ts were affected by the destiny of the Northeast Corridor since some proferred scenarios involved freight traffic originating, terminating, or moving over some of these lines.

Extensive evidence was taken in support of and in opposition to PC's claims. The issues are discussed at length in the GP's opening brief, which was in an advanced stage of preparation at the time of the PC settlement, but the remaining Ts by and large have not addressed these questions.

Appendix H

C. *Erie Lackawanna*

In 1973, the EL system included 2,627 miles of track (exclusive of trackage rights) between Chicago and the NJ/NYTerm. Its principal line connecting the two points ran 970 miles; the system also included three feeder lines: from Marion, Ohio, to Dayton and Cincinnati; from Leavittsburg, Ohio, to Cleveland; and from Cuba and Hornell, New York, to Buffalo and Suspension Bridge, New York. Freight operations were conducted over the entire system, and commuter passenger traffic over 165 miles in Northern New Jersey. Two thousand ninety-five miles of EL's system were conveyed under the Rail Act.

EL's major contention is that a substantial portion of its freight lines would have been sold to a profitable railroad for continued rail use. EL argued that the road's chief problem was a lack of cash, which purchase by a profitable carrier could remedy. Western railroads — Santa Fe, Burlington Northern, Missouri Pacific, Southern Pacific, and Union Pacific — needed to preserve their connections to the East and thus were principal candidates. EL claims that an acquisition package suiting a Western acquirer's needs would have included the EL main freight lines between Chicago and Jersey City, as well as feeder lines to Cleveland and Buffalo and heavy density branch lines — 1,741 miles in all, of which 1,455 were conveyed pursuant to the Rail Act. EL labelled this package the EL Western acquisition. EL contends, however, that the potential acquirers would have been more likely to purchase a combination of EL and LV lines. This second package, the EL-LV Western acquisition, would have included the LV main line between the NJ/NYTerm and its connection with EL's main line near Waverly, New York, in place of EL's line between NJ/NYTerm and Binghamton, New York, (via Scranton, Pennsylvania) — 1,538 miles of the EL system in all, of which 1,252 were conveyed. EL's development of the EL-LV combination assumed that both EL and LV freight lines in New Jersey would have been part of the NJ/NYTerm, although they

also claimed that the earnings value of this combination would have been enhanced by inclusion of their individual New Jersey freight lines (other than those proposed for abandonment by EL) had the JTs not come into existence.

EL argues that Chessie and Norfolk & Western, concerned by an invasion of the East by Western railroads, also would have had an interest in purchasing its east-west lines. The EL Chessie acquisition package includes the same EL properties as the EL Western acquisition except for the EL lines west of Sterling, Ohio, the junction between EL's and Chessie's main line to Chicago — a total of 1,382 miles of EL track, of which 1,315 were conveyed. A fourth package featured an EL-LV Chessie acquisition, with a configuration similar to the EL Chessie acquisition — 1,145 miles of EL's lines, of which 1,078 were conveyed. Similar configurations for acquisitions by Norfolk & Western were proffered, although not specifically developed in EL's financial submissions. The Norfolk & Western packages would have included EL's lines east of Huntington, Indiana, the junction with Norfolk & Western's system.

EL's analysis shows the following earnings values for these lines:

Acquisition	*Earnings Value (in $1000's)*
Western (EL)	$225,908
Chessie (EL)	$244,985
Western (EL-LV)/JT	$278,077*
Chessie (EL-LV)/JT	$251,561*
Western (EL-LV)	$294,660*
Chessie (EL-LV)	$293,693*

* Indicates earnings values for the EL-LV combination, not EL alone. The two last figures adjust the earnings values of the Western and Chessie EL-LV acquisitions to reflect inclusion of EL and LV's JT freight lines in the acquired properties.

SOURCES: First four figures from 3 GP at H 12. The last two figures are calculated from the EL's July 10, 1981, Statement, Part II, Sp. Ct. Rep. N 36153 using EL's witness' valuation methodology.

EL argues, however, that opportunity costs, including traffic lost if EL and other bankrupts were shut to down, traffic lost if competitors made the acquisition, reductions in car hire deficits, and other factors, see 1 ELF at 108-09, and New York's willingness because of the importance of EL's line into and through New York State to make $100 million available to a private acquirer to facilitate the purchase, would have induced an acquirer to pay more than earnings value. In particular, EL asserted that it would have received a higher price based on "net salvage value",[10] which it computed for its properties as follows:

Acquisition	*Salvage Value (in $1000's)*
Western (EL)	$370,653
Chessie (EL)	$333,540
Western (EL-LV)	$310,854*
Chessie (EL-LV)	$273,741*

* The figures for the EL-LV combinations do not include the salvage value of $43.4 million for EL's freight lines and of $34.9 million for LV's lines in the JT area and of $39.6 million for LV's non-terminal lines.

SOURCE: 3 GP at H 12.

EL also contends that New Jersey would have purchased EL commuter lines (in addition to public acquisition of its JT area freight lines) for continued rail use due to their central role in New Jersey's commuter rail system. EL claims that the acquisition price would have included 10 percent premium over net salvage value, reflecting a combination of $5.7 million for the difference between net and gross liquidation value and $4.9 million for "going concern value". The State supposedly would have been willing to pay these additional amounts based upon a fear that a condemnation award would be even higher and a desire to avoid the litigation costs of condemnation proceedings.

Appendix H

D. *Lehigh Valley*

The LV had operated a 430-mile main route between Buffalo/Niagara Falls and Oak Island Yard near Newark, and 425 miles of branch lines. Five hundred thirty-nine miles of these lines were conveyed pursuant to the Rail Act. In addition, LV leased 128 miles of the Lehigh & Susquehanna that paralleled LV's main line in Pennsylvania on the opposite side of the Lehigh River. These lines were also conveyed, and are included as part of LV's rail use proffers.

LV suggested three possible rail use packages in which its properties would have been purchased in the absence of the Rail Act. The first involves sale as part of the EL-LV combination. This would have included LV's conveyed lines in Pennsylvania that continue from NJ/NYTerm and connect with EL just outside of Waverly, New York, near Sayre, Pennsylvania, as well as its lines from Sayre northward through Ithaca to Ludlowville, New York, and its terminal properties in the Buffalo area—382 miles, plus 113 miles in the NJ/NYTerm area and the leased L&S lines in Pennsylvania. The earnings values of the EL-LV combination in the Western and Chessie acquisitions were included above in our discussion of EL's proffers. The net salvage values for LV's properties are claimed to be $39.6 million (the same lines are involved for either acquirer), in addition to $34.9 million for its lines that it claims would be included in NJ/NYTerm. At oral argument EL and LV agreed that an award for an EL-LV combination based on earnings value should be divided in accordance with estimated salvage values. Tr. at 67, 107.

In addition to the EL-LV acquisition, LV claims that another possible outcome would have been the acquisition of its rail use properties, totalling 641 miles including the Lehigh and Susquehanna and LV's New Jersey properties (thus assuming the absence of a JT purchase by public bodies), as a single package by a large railroad capable of carrying freight between LV's lines

and more southern and western gateways. This package would yield an earnings value of approximately $75 million in early 1974 and $95 million as of April 1, 1976.[11]

Finally, LV argues that if none of the possibilities for private acquisition had materialized, 609 miles of its track would have been acquired at "non-earnings appraisal value" for the most part by the states[12] where its lines were located. The salvage value claimed for the New Jersey lines is the $34.9 million noted above in connection with valuation of the EL-LV combination. The lines in Pennsylvania were suggested to have a salvage value of $20 million and the New York lines of nearly $3.5 million. This proffer does not include LV's Buffalo area properties that it contends would have been kept in rail use as part of a Buffalo terminal system. Although included in the EL-LV capitalized earnings studies, as public acquisitions they would be valued as "specialized properties", a determination that has been deferred to a later phase in the case. Second Pre-Trial Order ¶ 12, Sp. Ct. Rep. at N 11802.[13]

E. *Reading*

As in the case of PC, despite the settlement of claims of all components of the Reading System, it will be useful to summarize R's case because of its bearing on those of other Ts.

In 1973, R's lines covered 1160 miles, mostly in eastern Pennsylvania with some lines extending into Delaware and New Jersey. Its principal freight lines connected Reading, Pennsylvania, with Lurgan, Pennsylvania, (via Harrisburg), Reading with Allentown, Reading with Philadelphia, and Philadelphia and Allentown (the latter using trackage rights) with Bound Brook, New Jersey. R's passenger services were in the Philadelphia area. Eighty-eight percent of its lines were conveyed under the Rail Act.

R claimed that 347 miles of its freight properties, designated "class (a)", would have been sold to a private purchaser in the

absence of the Rail Act, at an earnings value of $200 million. Chessie was identified as the most likely purchaser; Norfolk & Western and the acquirer of PC's lines west of Harrisburg would also have been interested. "Class (b)" properties—265 miles of freight and passenger properties—it alleged would have been purchased by unspecified public bodies: $67 million for the freight properties (as part of the JTs submission) and $61 million for its passenger properties. Memorandum Accompanying Dec. 31, 1978 Evidentiary Submission at 10-11. The latter claim included a 50 percent premium over net salvage value, which was predicated upon estimates based upon examinations of past negotiated acquisitions between public and private bodies, the social importance of the property, and arguments that public bodies would pay to avoid condemnation risks and costs. Finally, although R concurred in the latter portion of LV's arguments which R claims indicate the likelihood that its remaining conveyed properties, labelled "class (c)", would have been purchased for rail use by public authorities or groups of shippers, it does not contend that the acquisitions would have been at prices in excess of nonrail use value.

F. *Central Railroad of New Jersey*

In 1973, the CNJ system included 825 miles of freight and passenger lines within New Jersey, 756 of which were conveyed under the Rail Act. CNJ contends that it would have sold all its New Jersey rail assets (including those not conveyed) to the State of New Jersey for $100 million in the absence of the Rail Act. The CNJ's case emphasizes its value as perceived by a prospective purchaser, the State of New Jersey, as opposed to calculations of hypothesized earnings or scrap value performed after the fact by external sources. Its $100 million estimate is based upon discussions it had with state officials that were terminated as a result of our decision in the *180-Day Appeals*, 384 F. Supp. 895 (1974), holding that the CNJ should be reorganized

under the Rail Act. The CNJ claims further support for this valuation based upon appraisals of its scrap value that ranged from $80 to $121 million.

G. *Ann Arbor*

The AA had operated approximately 290 miles of lines from Toledo, Ohio, just south of the Michigan border, through Ann Arbor to Frankfort, Michigan, where car ferries operated to two points in Wisconsin. Two segments of its lines were conveyed. AA claims that the Ann Arbor-Toledo segment, approximately 54 miles, would have been purchased by the State of Michigan for $9.7 million based on the line's earning value. With respect to the conveyed segment running 131.2 miles between Durand and Cadillac, Michigan, AA does not claim more than its value for nonrail use.

H. *Lehigh & New England*

In 1973, the L&NE consisted of two segments of line in Pennsylvania: the first, a 22-mile line from a connection with R and LV at Bethlehem to Uhler, Pennsylvania, interchanging with EL at Bath; the second, a 5-mile line connecting with R at Tamaqua, Pennsylvania. L&NE had been a subsidiary of CNJ and, while not abandoned when CNJ withdrew from most of its operations in Pennsylvania, no longer connected physically with any CNJ line.

L&NE contends that all its property would have been acquired for continued rail use based upon its earnings value to a solvent carrier acquiring the above-mentioned connecting lines. The earnings value of the Bethlehem segment was estimated to range from $1.05 to $3.2 million, and of the Tamaqua segment from $1.2 to $2.45 million, depending on the acquirer.

I. *Government Parties*

The GPs advance a broad general denial of the Ts' claims. Their basic position is that, whether or not particular segments

would have continued in rail use, the Ts would have realized no more than nonrail use values for their assets. Earnings values are claimed to be either negative or insufficient to justify offers in excess of scrap value, and public bodies would not have been compelled to offer premiums to acquire any properties. Moreover, the GPs proffer a "Master Liquidation Plan" wherein all the properties of the Ts would have been sold for scrap in a short period of time, with resulting glut depressing the values of their properties. This so-called "benchmark" value for all Ts including PC was originally stated to be $630 million. At oral argument the GPs indicated that this would be revised upward to approximately $1.26 billion and that roughly 20 percent of this, equivalent to approximately $252 million, would provide "some notion" of the then nonsettling Ts' share. Tr. at 563. During oral argument, the GPs continued to emphasize their claim that the Ts still had not discharged their burden of showing nonspeculative solutions to their predicament in the absence of the Rail Act that would have yielded values better than offered by the Master Liquidation Plan. Since the GPs' various contentions will be discussed at length in the course of our opinion, there is no need to detail them further here.[14]

III. Introductory Analysis

The *CMV Opinion* established that the Ts are entitled to compensation for the properties conveyed by them under the USRA's Final System Plan (FSP) for whatever they could have realized for them in the absence of the Rail Act.[15] Determination of that amount is the issue we must ultimately decide in this case. In this phase of the proceeding the issue is the more limited one stated in paragraphs (1), (2), and (3) of the Second Pre-trial Order, to wit, "the values that would have been received for disposition of . . . [the Ts'] properties for continued rail use in the absence of the Real Act".

In so phrasing the issue for this phase of the case, the court had in mind a model, developed in considerable part from earlier proceedings, somewhat as follows:

> (1) The Ts would endeavor to prove that certain freight lines would have continued in rail use and would have had a realizable positive earnings value exceeding "scrap value" however "scrap value" might ultimately be determined.
>
> (2) The Ts would endeavor to prove that other lines, primarily passenger lines, although without a positive and even with a decidedly negative earnings value, would have continued in rail use as a result of purchase by public bodies and that these purchases would have been made at more than scrap value.
>
> (3) The GPs would contest the Ts' assertions as to the amount of mileage that would have remained in rail use.
>
> (4) In other instances and, as a secondary position in the cases described in (3), the GPs would contest the Ts' ability to have realized more than scrap value.
>
> (5) In cases where the court sustained the GPs' arguments described in (3) or (4), it would reserve the determination of scrap value to the second phase of the proceeding, which would also include the valuation of properties that the Ts conceded would not have continued in rail use.

The proceeding did not develop that way. One complicating factor was the introduction of the concept of the JTs, with public bodies assumed to have purchased the predominantly freight lines at "net salvage value" and the predominantly passenger lines within the JTs at a premium above this. Another was the proposal of several Ts that lines would be sold for continued rail use at "net salvage value". This is a concept the components of which

have not yet been fully explored and as to which different Ts may hold different views. Clearly, however, there is a wide gap between the Ts' concept of "net salvage value" and the GPs' concept of scrap value as embodied in the Master Liquidation Plan.[16]

As a result of these factors and perhaps others, the vast record and the exhaustive briefs contain little discussion of which of the proffered lines would have been continued in rail use even if a T's estimate of earnings value were not realized.[17] In order to be sure that the court was not misapprehending the GPs' apparent unwillingness to challenge the Ts' proffers on the ground that lines without substantial earnings value would not have continued in rail use, the court, on May 26, 1981, addressed a letter to the Chairman of the GPs' and the Ts' Steering Committees, Sp. Ct. Rep. N 36201. After noting that its reading of the briefs indicated that "the debate appears to be not so much over what lines would be continued in rail use but as to what the transferors would have obtained for them", the letter said that the court would be assisted by the GPs stating prior to the oral argument "which, if any, of the proffered lines the Government Parties contend would not have been continued in rail use regardless of sales price." The GPs' answer of June 3, 1981, Sp. Ct. Rep. N 35829, essentially accepting the court's characterization of what the debate had been, declined to furnish such a list. They stated that they "cannot and do not contend that any particular proffered line (indeed, any conveyed line) would certainly *not* have been continued in rail use regardless of sales price." The letter went on to say that this was not a concession "that the proffered lines would have been likely to continue in rail use in the absence of the Rail Act". It proceeded to argue that the GPs' evidence showed that "even the most valuable of the transferors' lines would have had negative or very low earnings values"; that accordingly "sales to private purchasers may well have been impossible for virtually all of the transferors' properties"; that, in contrast, "sales of some lines to public bodies could not be entirely

ruled out"; but that this possibility did not matter because public bodies would not pay more than the Ts' best private marketplace alternative, to wit, sale at scrap value.

In the absence of any adversarial position by the GPs with respect to continued rail use of any particular line, the court would be justified in considering that all proffered lines would have been continued in rail use except in those instances where the development of a T's own case demonstrated that if a particular acquisition were posited, portions of its railroad would have been abandoned.[18] This course would involve no procedural unfairness to the GPs;[19] the court's May 26 letter gave them an opportunity to argue which proffered lines would not have continued in rail use at any price and they chose not to make the gambit since in their view of the law it made no difference.[20]

Despite this, court is not inclined to abandon all inquiry into whether a particular line would have continued in rail use. The GPs did offer extensive evidence that public bodies would not have acquired proffered properties at any price, not because these were insufficiently important from a transportation standpoint but because the public bodies lacked legal power or financial ability to make the acquisition. We shall never be in a better position to pass on such arguments than we now are. Moreover, despite the GPs' unwillingness to engage in debate over whether lines would or would not have continued in rail use, we cannot ignore the Ts' argument that in weighing the likelihood or unlikelihood of their proposed dispositions, the court must consider that the discontinuance of essential rail service was the most unlikely outcome of all, with the consequence that in the absence of the Rail Act some basically nonfederal solution to the problems of rail service in the Northeast would have been found.

The foregoing and other developments have caused the court to be increasingly concerned with what it may properly decide in this opinion. This concern led us to begin the final day of the argument by addressing a series of questions on this subject to counsel for both sides. Tr. at 408-16. Our questioning made

clear that the parties were using terms sounding like scrap value in many different senses. We shall start at the bottom, with the GPs' Master Liquidation Plan, which would price all the Ts' properties on the theory that all properties of all Ts, including those that would have continued in rail use, and even some of those so continued because of high earnings value if such there were, would have been sold for scrap at substantially the same time. Another model, characterized by CNJ as "the residual scrap model", CNJRB at 30, "would price the property remaining in rail use by looking at a market affected by the simultaneous scrapping of all properties that would be withdrawn from rail use".[21] A third is what CNJ calls the "stand-alone" model, wherein the scrap value of any T's property would be computed without regard to the fate of the property of other Ts. Presumably this could encompass pricing either on the basis of a scrap sale of all properties or of only those that would in fact have been withdrawn from rail use. Highest on the scale is the net salvage value theory, already discussed, see note 16, *supra*, and accompanying text, which deducts only some of the costs of sale.

One point that is quite clear to us and, indeed, seems to be agreed upon by all the parties except CNJ is that at this stage of the proceeding we cannot properly decide among these theories or endeavor to apply the chosen one or ones. In ¶ 1 of the Fourth Pre-Trial Order, filed May 16, 1979, we granted the motion of the GPs "to the extent it seeks to defer the consideration of evidence with respect to determining non-rail use values of any properties or appraisal methodologies for determining non-rail use values of any properties", Sp. Ct. Rep. at N 17130-31. Properly relying on this, the GPs did not cross-examine or rebut statements by the Ts' witnesses relating to the Ts' net salvage value, appraisal value, etc. On the other hand, in the same paragraph of the Fourth Pre-Trial Order we directed that "evidence that purchasers of lines sold for continued rail use would have paid prices established in whole or in part with reference to various different types of non-rail use values shall be presented during the rail use phase of these

proceedings". Much such evidence was presented, briefed, and argued.[22] We believe that judicial economy would be promoted by deciding, at this stage of the proceeding, which properties would have been acquired at prices related to their nonrail use value and whether or not the acquirer would have paid premiums above or negotiated deductions from scrap value. For simplicity we shall sometimes refer to the values that we will determine in the second phase of the proceeding simply as X.[23] We shall expect the parties to give us maximum assistance in expert testimony, briefs and arguments on what now seems the most important "cut-across" issue in the nonrail use phase, namely, what properties should be considered in determining "glut" for a particular T. See Sixth Pre-Trial Order ¶7, Sp. Ct. Rep. at N 35968. We recognize that this solution does not provide as neat a distinction between the first and second phases of this proceeding as we had anticipated, but it seems dictated by the manner in which the case has unfolded.

IV. General Background Considerations

The court is confronted in this case with a task of almost insuperable difficulty. That is to determine what action would have been taken by interests of all kinds — the Ts, other railroads, state and local public bodies, the United States,[24] the ICC, labor, and shippers, in order to avoid a shutdown of the Ts (including PC) which would have entailed disaster for all.

As witness Charles Shannon[25] said, testifying for the PC, "any attempt to determine how the Northeast rail crisis might have been resolved if Congress had not enacted the Rail Act in 1973 is an essentially unrealistic enterprise", since "[t]here was never any realistic likelihood that the federal government would allow market forces to play a prominent role in the way in which rail service in the Northeast would be restructured". Shannon (S) (PC) (Dec. 31, 1978) at 2. The GPs come close to suggesting that this unreality should foreclose our consideration of the Ts'

proposals concerning what might have occurred. They repeatedly call our attention to the statement in *Olson* v. *United States*, 292 U.S. 246, 257 (1934), that

> [e]lements affecting value that depend upon events or occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable, should be excluded from consideration . . . .

However, that sentence must read along with the previous statements that in respect of each item of taken property the court must estimate market value,

> deemed to be the sum which, considering all the circumstances, could have been obtained for it; that is, the amount that in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy;

that

> [i]n making that estimate there should be taken into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining;

and finally that

> [t]he determination is to be made in the light of all facts affecting the market value that are shown by the evidence taken in connection with those of such general notoriety as not to require proof.

Moreover, *Olson* involved a taking for a new use which the Court concluded no person other than the condemnor could accomplish and the statement relied upon by the GPs was addressed to that situation. While we agree with the GPs that the Ts bear the

burden of proof, this does not require them to show with something like mathematical certainty that hypothetical transactions would have occurred and hypothesized prices exactly realized. Their burden is simply to show by a preponderance of the evidence that transactions such as those proposed by them were more likely to have occurred than what the GPs argue was the Ts' next best alternative—abandonment and subsequent dismantlement. When they have satisfied that burden, the court must ultimately determine, as best it can, what the price would have been.[26]

The GPs begin their assault on the Ts' proposals, more particularly their freight line proposals, by painting a dismal picture of the conditions of the railroad industry, especially in the Northeast[27] as this appeared in 1973. A summary of this will suffice. For the facts the GPs relied heavily on a staff report of the Senate Committee on Commerce, dated December 1972, entitled The Penn Central and Other Railroads. They cite the report, 1 GP at A176-77, as concluding that railroads in this area suffered from

> [s]teadily declining freight volume, particularly in traditionally rail-carried bulk commodities such as coal, steel and forest products; outdated terminals that could not efficiently handle current volume, let alone any hoped-for increased volume; service problems, including an unbelievably high incidence of damage to shipments and inability to meet delivery schedules; steadily increasing competition from the more efficient motor and water carriers; deteriorated physical plants; outdated work rules and large job protection commitments; concerns of shippers, local governments and unions that would inevitably delay abandonments of unprofitable lines; and continued losses from fulfilling obligations to provide passenger service.

A significant source of the industry's problems was the relative decline in share of the gross national product represented by bulk

items as distinguished from services. Hence railroad shipments and revenues could fall even when the general economy was growing. Shifts in population away from the Northeast and the relocation of industrial plants into suburban industrial complexes and to points closer to the new population centers operated further to the disadvantage of the Northeastern railroads, many of which were left with substantial amounts of little used freight track into cities. For short and even for longer hauls of manufactured products, the railroads, because of lesser reliability and greater proneness to loss and damage, were unable to compete successfully with trucks. The GPs cite a gloomy report of the PC Trustees dated September 17, 1971, to the PC reorganization judge on the basic problems of the Northeastern carriers; on July 24, 1972, the LV Trustees rendered an even gloomier report to the same judge, claiming that, however bad PC's situation might be, PC was managing to maintain its strength at the expense of its smaller competitors. Declining earnings had led to deferral of maintenance, which led in turn to a further decline in service and revenue. The GPs' brief extensively recites statements by PC trustees as to the devastating effect of the number and expense of the freight terminals it was obligated to operate. On the other hand efforts in 1972 and early 1973 on the part of the R, LV, and CNJ Trustees to consolidate some operations in Northern New Jersey came to nothing, in part because representatives of the State were concerned over the impact of immediate large scale layoffs on organized labor. Antiquated work rules constituted a heavy burden, and the threat of labor protection payments clouded proposed shrinkage and mergers. Relatively little progress had been made in the way of abandonments. For many of the Ts, including EL and CNJ, as well as PC and R, passenger service created a further burden since state and local authorities were unwilling to subsidize more than avoidable costs.

The results of these developments were summarized in two tables in the GPs' opening brief, 1 GP at A 204, 206, comparing

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net railway operating income and freight operating ratios for five of the Ts for 1966 and 1972.

Net Railway Operating Income

	1966	1972
EL	$17 million	($7.7 million)*
R	$7.7 million	($12.1 million)
LV	($1.4 million)	($8.9 million)
AA	($288 thousand)	($1.1 million)
CNJ	($4.9 million)	($1.2 million)

* Numbers in parentheses indicate deficits.

Freight Operating Ratios

	1966	1972
EL	72.2%	83.3%
R	77.4%	89.5%
LV	84.2%	93.5%
AA	86.3%	93.1%
CNJ	89.1%	92.4%

The decline in net railway operating income was reflected in a decrease in cash flow and, with the accompaniment of inflation which made depreciation charges on equipment inadequate to provide for the cost of new equipment, required the railroads to incur even larger obligations, whether in the form of debt or leases, for the acquisition of new equipment. The average rate of return for railroads in the Eastern District, which includes profitable railroads such as Chessie and Norfolk & Western, from 1969 to 1973 was a mere 0.14 percent. Smith (S) (Jan. 30, 1980) Ex. 17 at 16. The GPs also call our attention to reports of trustees of the Ts to their respective reorganization courts in 1972 and 1973, many of which are cited in our *CUE Opinion,* 439 F.Supp. at 1359-62 (PC), 1381-82 (CNJ), 1383 (R), 1384 (LV), 1386-87 (EL), as to imminent cashlessness and the consequent need to shut down the railroad.

Citing from our *CMV Opinion,* 445 F.Supp. at 1088, the GPs conclude, 1 GP at A 211-12:

> It is difficult to envision against the picture painted in this Section—largely from published data from rail sources and from other contemporaneous public documents—that profitable railroads would have found it "in their 'own self interest' " to have paid large sums for the privilege of standing in the shoes of the transferors.
>
> It was clear in the early days of 1973 that none of the transferors could be reorganized on a conventional private income basis. They were faced with outworn physical facilities, heavy debt, negative earnings, inability to raise astronomical sums of essential capital, adverse economic trends beyond their control and operating problems which had been unsolved for decades.

They argue from this that "no rail use values inhered in the transferors' properties" and that they "are entitled to recover no more in these proceedings than the realizable nonrail use value of their properties".

The Ts do not deny that the 1973 picture for the Northeastern railroads was sombre. Their answer to the GPs is rather, to use Mr. Justice Holmes' phrase in his dissent in *Lochner* v. *New York*, 198 U.S. 45, 76 (1905), "General propositions do not decide concrete cases". As the case now stands, the only instances where we must determine the possibility of sale on a capitalized earnings basis are greatly pared-down versions of both EL and LV; the short Ann Arbor-Toledo segment of AA; and L&NE.

EL urges, 1 ELF at 27-34, ELRB at 14-22, that in 1973 it had one of the highest density ratings in the nation and the longest average haul of any carrier in the East; that its lines were in relatively good condition; that it had been steadily increasing its share of the eastern market, was well managed, and enjoyed excellent relations with shippers and labor. EL had rebounded from the adverse effect of the PC merger and produced freight net railway operating income of $11 million in 1971. It entered bankruptcy only in 1972, in consequence of the devastation

wrought to it and many of its shippers by Hurricane Agnes. In an order entered on April 3, 1974, pursuant to § 207(b) of the Rail Act, the judge in charge of EL's reorganization found that EL was reorganizable on an income basis pursuant to § 77 of the Bankruptcy Act. He relied upon a statement of position by the EL trustees "supported by comprehensive evidence, financial projections and economic feasibility studies by the highly respected Salomon Bros., banking and financial consultants, and Wyer, Dick & Co., railroad consultants". Plans for EL included the rebuilding and rehabilitation of its yard at Marion, Ohio, which was expected to pay for itself in two years and for which Salomon Brothers had already obtained financial commitments aggregating 80% of the cost, and also its yard at Croxton, New Jersey. EL contends that the only weakness in the plan it presented to the reorganization court was "a dangerously tight cash position in 1974 and 1975". 1 ELF at 33. This weakness became fatal as a result of the recession of 1974-75, accompanied by continued inflation. In an order dated January 18, 1975, the reorganization judge carefully reviewed these unexpected developments and concluded that EL no longer had the ability to continue reorganization on an income basis. However, EL contends, these adverse developments would not necessarily have precluded a solvent railroad from believing in 1973 and later years that EL, while perhaps unable to survive as an independent railroad, would have been attractive as part of a larger system if shorn of the burden of passenger deficits and unprofitable branch lines, and, as we shall see, EL submitted substantial evidence to that effect.

LV likewise contends that its admittedly bad condition prior to the Rail Act is not inconsistent with its claim that the proffered portion of its lines would had have earnings value as part of a larger system. It points out that from 1962 until PC's and its own bankruptcies in 1970 it was under the control of the Pennsylvania Railroad and, after the 1968 Pennsylvania-New York Central merger, of PC, both of which were competitors; that, as predicted by the hearing examiner on the Pennsylvania-New

York Central merger, this caused substantial diversion from LV; and that its Trustees had had significant success in rebuilding its traffic base. Beyond this many of LV's problems were attributable to its relatively short mileage, its longest possible haul being 443 miles between Jersey City, New Jersey, and Buffalo, New York, with the result that it received a small proportion of total revenues while bearing heavy terminal expense. This problem would have been alleviated by LV's inclusion in a larger system. Moreover, the portion of LV conveyed pursuant to the Rail Act, most of which was here proffered for continued rail use, was, in LV's words, LV at 16, "a very different system than the one the Trustees operated before conveyance". The FSP did not designate LV's main line west of Van Etten Jct., New York, or various branch lines in New York and Pennsylvania which "produced substantial costs and virtually no income", *id.*

AA claims, somewhat similarly, that the unprofitability of its 298-mile rail system as a whole casts little light on the earnings value of the 54.2-mile Ann Arbor-Toledo segment, which is all that is at issue here. Doubtless because of the special nature of its case, discussed in Part XIII of this opinion, CNJ makes no particularized reply to the general arguments of the GPs here under consideration.

The upshot of all this is that while the general arguments of the GPs being here considered suffice to create a considerable degree of scepticism over the Ts' assertions of earnings value, they do not relieve this court of the onerous task of detailed analysis of the Ts' proposals. If a T has presented a set of figures produced by competent witnesses which show significant capitalized earnings value, we cannot simply reject the proposition that the T might have obtained more than X from a solvent railroad, no matter how dismal the record of the past had been. We therefore turn from the background quite properly presented by the GPs to the specific claims advanced by the Ts.

Appendix H

V. Bargaining for Properties Having Earnings Value

Establishment by a T of a capitalized earnings value higher than X does not necessarily mean that the T would have been able to realize this in the marketplace. It might not have been able to realize that much; conceivably, if the "earnings" that were capitalized were simply those on the purchase line and other elements of value to the purchaser were not taken into account, it could have gotten more. As indicated in our *CMV Opinion*, 445 F.Supp. at 1044, the amount would have depended on a process of bargaining—a process which, the GPs insist, would have included not only the buyer and the seller of the particular property but many other railroads and public bodies on whose purchase of losing properties the earnings value of others would depend.

The parties produced two distinguished academics as witnesses on the subject of bargaining. The GPs called Donald Jacobs, Dean of the Graduate School of Management at Northwestern University; his direct testimony is contained in a volume entitled "The Nature and Consequences of Likely Bargaining among Interested Participants in the Alternative Scenario". PC called in rebuttal Thomas Schelling, Professor of Economics at Harvard University and Professor of Political Economy at its John F. Kennedy School of Government. Although his testimony was addressed primarily to the IFLs, many of his observations apply also to the properties here before us. In addition Shannon's testimony for EL and PC and Professor Alain Kornhauser's[28] testimony for PC entitled "Opportunity Costs for Potential Purchasers of the Intercity Freight Lines", contain a considerable amount of discussion about bargaining.

Professor Schelling did not disagree with some fundamental principles stated by Dean Jacobs, which we find it useful to set out. The most basic of these were:

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27. The fundamental principle of bargaining is that each party seeks through agreement to improve his position over that which it would occupy in the absence of agreement. A corollary is that parties assess the motivations and bargaining strengths of opposing parties with reference to those parties' alternatives. Parties will reach agreement if they believe that doing so will leave each of them at least as well off, and at least some of them better off, than they would have been in the absence of agreement.

* * *

29. In bargaining between a buyer and seller regarding a proposed sale of property, agreements are reached only if the property is at least as valuable to the buyer as it is to the seller. Only in such instances would a rational buyer be willing to pay enough to induce the seller to part with the property. If the seller is rational, it would not be willing to sell the property to any buyer for less than the value it could otherwise realize (by keeping the property or by selling it to another buyer). By the same token, a rational buyer would never pay more for a property than the value of that property to it (or more than it would have to pay to buy a substitute property of equivalent value to it). The maximum amount that the buyer would rationally pay for the property is called the buyer's "reservation price," and the minimum amount that the seller would rationally accept for the property is called the seller's "reservation price." Thus, if the buyer and the seller are rational, they will not agree on a sale of the property if the buyer's reservation price is less than the seller's reservation price.

Jacobs (S) (Nature and Consequences) (Nov. 1, 1979) at 11-13. Dean Jacobs called the excess of the buyer's reservation

price over the seller's reservation price "excess value". He testified also that account must be taken of the ability of third parties to postpone, prevent, or have disadvantageous conditions placed on the sale. Amounts required to be spent, whether by the buyer or the seller, to obtain the assent of such third parties would reduce the amount otherwise realizable by the seller.

It is worth noting at this point that ambiguities as serious as those to which we have already referred, see p. 28 & n.16, 30, *supra*, with respect to the parties' use of such terms as scrap value, salvage value, etc., which would constitute the seller's reservation price since the seller could obtain this amount without making the sale, are also present in the parties' references to earnings value. We find scattered through the record the following concepts of the earnings to be capitalized or otherwise taken into account; we have arranged these generally in ascending order:

> (1) The assumed future earnings of a line conceived as carrying essentially the same traffic as it did before the acquisition, increased or decreased only in accordance with estimates of general economic conditions.
>
> (2) The earnings reflected in (1) plus cost savings resulting from the acquisition.[29]
>
> (3) The earnings reflected in (1) and (2) plus earnings the buyer would have lost if the seller had ceased operation.[30]
>
> (4) The earnings reflected in (1) and (2) plus earnings the buyer would have lost if all the bankrupt carriers had ceased operation.[31]
>
> (5) The earnings reflected in some or all of the preceding plus earnings on traffic from or to points on the acquired road which the acquisition would permit the buyer to divert to its own line.[32]

(6) The earnings reflected in some or all of the preceding, plus earnings on traffic which in the absence of the acquisition would not have moved by rail at all.[33]

A capitalization of "earnings" that includes items at the upper end of this scale will produce a higher buyer's reservation price and consequent excess value than those at the lower, just as use of the Master Liquidation Plan's approach to scrap value rather than the Ts' various salvage value approaches will produce a lower seller's reservation price. Yet apparently neither Dean Jacobs nor Professor Schelling had been made aware of the ambiguities in what they conceived as the reservations prices of the two parties. Their conclusions, more particularly some of Dean Jacobs', must be read with this in mind. Thus, while one may readily accept that a buyer would not pay more than capitalized earnings value if that term included all the elements in the preceding scale, it is by no means clear that a buyer would not go beyond earnings value computed as outlined in (1) or (2).

Despite this we are inclined generally to accept Dean Jacobs' conclusion (although not all his reasons for it) that the seller would realize a relatively small share of "excess value" if there is only one potential buyer. The only leverage possessed by such a seller would be the threat to close down operations. We do not minimize this. Table B to Shannon's EL statement showed, for example, that assuming a 70 percent loss to Santa Fe of the 1973 traffic handled between Santa Fe and EL by a shutdown of EL alone and a 60 percent incremental cost ratio for handling the traffic, Santa Fe would have suffered an annual loss of $5,780,516 in pretax net income.[34] However, the 70 percent estimate appears to be on the high side, especially if one or more of PC's lines east of Chicago remained in operation.[35] Moreover, a buyer offering something more than X, particularly if this were X in one of its higher ranges, would find the seller's threat to refuse this and close down operations lacking in credibility. For one thing, if the offer were high enough in terms of X, the ICC would have

refused to permit abandonment (in the sense of dismantlement) pursuant to its established policy, see note 16, *supra*. Apart from this the trustees of few railroads of any size or the judges presiding over their reorganizations would have been perceived as having the moral stamina to force an actual shutdown, thereby foregoing any chance ever to realize more than had been offered[36] and becoming the subject of obloquy from public officials, shippers, and labor, when they had on the negotiating table an offer for something more than could be obtained by scrapping the road.

Our view that in the single-bidder situation the seller would not receive much over X must be qualified, however, by an important caveat, namely, that neither buyer nor seller would have known just what X would be. This would not have been so much for lack of information; several, perhaps all, of the reorganization courts had directed appraisals of the bankrupts to be made, and many of these were available in 1973. It was rather that no one knew how these appraisals would translate themselves into reality. What counts is what the buyer would have perceived the seller's likely receipts from dismantling or condemnation to be. Saying that in the absence of a competing bid the seller would not have received much of the excess value does not mean therefore that he might not have obtained considerably more than the prices contained in the Master Liquidation Plan.

Before considering what the division of the excess value would have been under competitive bidding, it is necessary to address the question whether such bidding would ever have existed. The GPs argue that it would not, since the interests of prospective bidders, especially if these were railroads, would have led them to join in bidding as a consortium. The motivation for this would have been not only to buy at a cheaper price but to avoid the disruption of traffic patterns that would have resulted, *e.g.*, if different Western roads had purchased various IFLs and EL. While any such purchases would have afforded opportunity for

diversion, the benefit of this might have been decreased or nullified by similar opportunities afforded by similar purchases by others, see note 32, *supra*.

We ourselves introduced the notion of purchase by a consortium when, in the *CMV Opinion*, we said, "we do not at all exclude such possibilities as joint action by the transferors in the Northeast Region or joint purchases by profitable railroads to the west and south which ordinarily might have been deemed objectionable under the antitrust laws", 445 F.Supp. at 1010. Although the prime thought behind our suggestion of a joint purchase was to overcome problems of lack of adequate financial resources,[37] we also had in mind the elimination of the opposition before the ICC and the endless battles over protective conditions and inclusion that have spun out the length of many railroad merger proceedings—sometimes to the point of killing the merger. Clearly § 5(11) of the Interstate Commerce Act, 49 U.S.C. § 11343, authorizes the Commission to confer antitrust immunity on carriers who have joined in purchasing another railroad, and the Supreme Court has approved its doing so, *Minneapolis & St. Louis Ry.* v. *United States*, 361 U.S. 173 (1959).[38]

Despite this we have the gravest doubt whether the Commission would have authorized a combination of all prospective bidders to purchase all the lines here proffered. No one has contended that the potential bidders would not have had resources adequate to effect the proposed purchases.[39] Hence approval of a consortium purchase could not be defended on the basis that it would not depress the market since otherwise there would have been none. Insofar as an objective of the consortium would have been to lower the price the Ts would have received, we do not see why it would not violate the antitrust laws just as does bid-rigging which results in the purchaser having to pay more, see *United States* v. *Koppers Co.*, 652 F.2d 290 (2 Cir. 1981); the antitrust laws are as concerned with sellers as with buyers. To be sure, § 5(11) empowers the Commission to grant exemption from the antitrust laws, and it can be argued that the Commission

would have been predisposed to do this since its primary interest lay in the continuation of rail service at the lowest cost. As against this the Commission would have realized that investment in railroad securities would hardly be promoted by its endorsing a policy that if a railroad has to be liquidated, prospective competing buyers can permissibly join forces to depress the purchase price. As to the alleged pro-competitive factors in a consortium acquisition through preserving established traffic patterns, we would think that, however forceful these considerations may have been in the case of a short-line "bridge carrier", such as the Toledo, Peoria & Western, which had observed and was pledged to continue to observe a policy of "strict neutrality between all connections", *Minneapolis & St. Louis Ry., supra*, 361 U.S. at 189, the situation would appear quite different if a half dozen or more carriers were buying the properties at issue here. Individual acquisition of various lines would open up possibilities of more aggressive competition, not simply by more energetic sales effort but because of the possibility of more efficient single line service; this is hardly to be disregarded because competition for shipments which had been and would continue to be handled interline between the acquirer and property acquired by another might be disadvantaged. Beyond all this we do not readily foresee the feasibility of a six or eight party management practicing a policy of strict neutrality over a system as large as this—a situation altogether different from the common joint ownership of local terminal railroads. The possibilities for friction would be endless; management might have to spend as much time quieting the sensibilities of the owners as running the railroad. In particular we perceive no likelihood of a consortium consisting of both Western and Eastern lines, since their objectives would have been directly opposed. In sum, while we cannot categorically say that the ICC would not have approved acquisition by a consortium, we think the odds would have been overwhelmingly against this outcome.[40] For these reasons we find it unnecessary to consider whether introduction of the concept of a consortium would be

inconsistent with basic notions of eminent domain law with respect to a free market.

Once the hypothetical transaction is visualized in terms of competitive bidding, the basis for Dean Jacobs' prophecy that little excess value would find its way into the hands of the Ts largely breaks down. We see no force in the GPs' contention that a railroad having an interest in acquisition would not enter the contest if it perceived that another would be likely to bid more. This assumes a degree of information about the intentions of other parties which normally does not exist. Beyond that, a railroad, even if not expecting to be successful, might have an interest in driving up the price a competitor would have to pay. The GPs correctly point out that we must consider not only competition among buyers but also competition among sellers. While no one can do more than guess, we would suppose that in a two-bidder situation, after making deduction for payments that would be required to be made to third parties, the road having the lesser interest would have bid well up toward its reservation price and the road with the greater interest would have topped this by a relatively small amount.

VI. The Effect of Inflation on Earnings Forecasts

The GPs, without quantifying the amount of the adjustment urged to be required, attack the Ts' projections because of their failure to allow for the allegedly detrimental effect of inflation on earnings. The GPs presented their evidence through a qualified witness, Russell Murphy.[41]

Murphy's thesis was that between 1967 and April 1, 1976, three separate influences had caused railroad earnings to suffer as a result of inflation and would be expected to continue to do so. These were as follows:

(1) The railroad industry voluntarily chose not to petition the ICC to recover the entirety of its inflated costs.

(2) The ICC awarded the industry less rate relief than the industry ultimately sought—partly in the interest of shippers and partly because it believed the requested increases would cause such loss of traffic as to be counter-productive. See, *e.g., Increased Freight Rates and Charges, 1975, Nationwide, Ex parte* 310, 349 I.C.C. 555, 575 (1975); *Increased Freight Rates and Charges, 1973, Nationwide, Ex parte* 295, 344 I.C.C. 589, 637 (1973).

(3) The industry, primarily because of competition from other modes of transportation, did not implement fully the rate increases that had been granted.[42]

Examining the 14 general rate increase proceedings conducted by the ICC between 1967 and April 1, 1976, he found that although the roads reported inflated costs of $10.614 billion, the roads had sought increases of only $8.255 billion, and had been granted increases of only $8.229 billion. However, because of a variety of factors—fears of loss of traffic to other modes of transportation, delay in obtaining permission to increase intrastate rates, and "accounting delay", the railroads realized only some 82 percent of the increases authorized.[43] This picture, however, had somewhat improved after 1973. In the four general rate increase authorizations for which data were reported by the industry before April 1, 1976, an average revenue yield of 92.5 percent of authorized increases was realized. R. Murphy (S) (Jan. 30, 1980) at 35-39.

The portion of EL's opening brief dealing with this subject largely contented itself with relying on testimony of James White, Chessie's Director of Cost and Economic Analysis and author of the Chessie study of EL and R, that Chessie used constant dollars because "we generally found from studies that freight revenues generally inflate, in some cases, slightly greater, but not significantly greater than do costs", White (D) (July 20, 1977) at 365-66, EL App. K at 146-47; of John Darling, Director of Cost

Analysis and Research for Santa Fe, who said that use of constant dollars was "an appropriate method of financial analysis in the railroad industry", Darling (D) (July 31, 1980) at 28, EL App. K at 150; and Frederick Smith[44] the GPs' chief valuation witness, who acknowledged that he had performed a constant dollar analysis for his employer, First Boston Corporation.[45] See 2 ELF at 410-12.

In its reply brief EL made a more extensive answer, ELRB at 172-85. This starts with an assertion that Murphy's data with respect to increased costs were based on a summary prepared in 1979 by the Association of American Railroads (AAR), which seems to have relied on the railroads' submissions in the increased rate cases. In testing his model Murphy compiled actual cost data for the railroad industry for the period 1966-76. This allegedly demonstrated that for the period preceding the Ts' proposed 1974 disposition date, 1966-73, the actual cumulative cost increases experienced by the railroad industry totaled $5,373 million, as compared to the $6,965 million reported by the AAR. The cumulative revenue increases authorized by the ICC for the same period totaled $5,573 million, so that these more than recovered the railroad's increased costs.[46] EL supports this by citations to various ICC proceedings in which the Commission found the railroad's cost claims, which were those in the AAR data, to be overstated.[47] It goes on to make three criticisms of the portion of Murphy's study concerning the relationship between increased costs and rate increases, the most important being that the study underestimated total rate increases because it took into account only general rate increases achieved in nationwide *Ex parte* proceedings, ignoring annual volume rates which are frequently subject to automatic escalation clauses and other specific tariff filings. EL contends that Murphy's conclusion that the roads did not obtain rate relief equal to their increased costs thus cannot stand.

Turning to Murphy's final point, the alleged failure of the railroads to realize the full rate relief accorded by the Commission, EL contends that the Commission took this into account in granting rate relief. Admitting that the ICC has concluded that the railroads realize only some 82 percent of the rate relief authorized,[48] EL says that the Commission grants increases such that 82 percent realization would meet increased costs, see *Ex Parte 265 & Ex Parte 267, supra,* 339 I.C.C. at 177-78; *Ex Parte* 357, 359 I.C.C. 740 (1978). In addition EL called attention to a report of a USRA panel, of which Murphy was named as a member, which minimized the fear of diversion to trucks as a factor that would prevent Conrail from raising its rates to meet inflation by saying that "the effect of inflation on the cost levels of the two modes was essentially the same". R. Murphy (D) (May 19, 1980) Ex. 52 at 4, EL App. O at 640; ELRB at 182.

We believe that EL has satisfactorily answered Murphy's claims.[49] It is clear that, at least in the cases which a buyer would have regarded as most relevant, the ICC granted increases in a nominal amount greater than the railroads' increased costs because of its perception that only a fraction, say 82 percent, would be realized. Taking, for example, the figures in note 46, the yield on authorized rate increases would be 82 percent of $8,229, or $6,748 million leaving a shortfall of $725 million. This is not a stupendous amount for the entire railroad industry over a ten year period. Even this estimate is undoubtedly too high since it does not include any allowance for specific tariff filings and automatic escalation clauses. Finally, Murphy does not and cannot answer the testimony of White and Darling, executives of railroads who were potential acquirers of EL and LV, to the effect that inflation was not a serious concern.

VII. Valuation Methodology

There are two components to be considered in valuing an asset: the amount of cash it generates and the discount rate. The first

component is obviously important—an investment yielding $100 a year is worth twice as much as one yielding $50 a year. The second component is equally important—$100 now is worth more than $100 ten years from now. All the parties agree that these are the two relevant concerns. Where they disagree is on how to measure them.

A. *DCF vs. EBIT*

The parties used essentially two different methods for valuing the earnings claimed to have been generated by the Ts' properties. The GPs, PC, and, with modification, EL determined the present discounted value of the distributable cash flow (DCF) generated by the enterprise. Under this approach, one first projects DCF for future years. DCF is essentially earnings plus after-tax interest, principal payments, and depreciation minus taxes and capital expenditures needed to maintain earnings.[50] As its name implies, DCF represents the funds that can be distributed to all investors, including bondholders, without impairing the earning power of the enterprise. The next step is to discount DCF for future years to present discounted value (PDV) using an appropriate discount rate.[51]

AA capitalized earnings before interest and taxes (EBIT) for a normalized, or average, year. L&NE capitalized earnings before interest but after taxes, assuming a 50 percent tax rate. EBIT represents what its name implies—earnings with interest, principal payments, and taxes added back in. This figure is then capitalized using an appropriate interest rate on the assumption that the enterprise will generate normalized (an average year's) EBIT in perpetuity.[52]

On balance, the court believes that the approach presented by the GPs' expert witness Smith[53] is preferable to AA's and L&NE's method. The advantages of using DCF are highlighted by examining the three key differences between the two methods:

the effect of timing, the impact of taxes, and the treatment and estimation of capital expenditures needed to maintain income.

1. *Timing*

The first major difference is that DCF relies on a series of annual projections while EBIT uses a single average year. Smith argues that by using annual projections rather than a single average year, it is easier to assess the effect of the forces that affect earnings. While we are not convinced that trying to assess the impact of these trends on twenty numbers is necessarily easier than assessing them on one, the use of annual projections does have the major advantage of allowing one to take account of the effect of time on present value.

As a rule, the earlier one realizes income the better. The use of a single normalized year blurs the effect of the timing of the receipt of income on the capitalized value of an enterprise by assuming that earnings will be realized in a constant flow. If one is able to project that some years will be better than others, while the average earnings for two companies could be the same, the capitalized value of their earnings streams could be quite different. An illustration of this is given in the margin.[54]

Of course, the GPs' witness did not assume that an enterprise would disappear at the end of twenty years. Smith assumed that the final year's cash flow would represent the expected normalized year's experience and calculated the capitalized value of that figure. The result, called the terminal value, is then discounted to PDV.[55] The total value of the enterprise is equal to the PDV of the annual cash flow projections plus the PDV of the terminal value.

While the GPs' witnesses thought that twenty or thirty-year cash flow projections would be optimal, no GPs' witness projected detailed annual cash flows for EL, LV, AA, or L&NE. Instead, the GPs relied on the projections made by the Ts themselves. EL relied on DCF for the first four years and after-tax earnings for

the fifth year. EL hypothesized that its fifth-year eanrings would represent a normalized year and calculated the terminal value of its proffer from that figure. AA and L&NE did not present any annual projections of their earnings and relied solely on an estimate of a single year's normalized earnings.

2. *Taxes*

The second major difference between DCF and EBIT is the treatment of taxes: DCF is an after-tax figure, EBIT is a before-tax figure. The GPs' expert testified that since investors are generally interested in the amount of money left over after every one else, including federal and state governments, has taken his cut, after-tax figures should be used in valuing an enterprise. We do not believe the Ts to dispute him on this point. Rather, AA, the only T other than LV[56] that used before tax figures, argued that the GPs' proposed adjustment to EBIT in their particular cases is inappropriate.

AA's expert, James Laurie,[57] argued that AA should be valued on a pre-tax basis since one of the bidders for its property, the Detroit, Toledo & Ironton (D,T&I), was tax exempt because of its significant loss carryforwards. But as the GPs point out, even if one accepts AA's contention that D,T&I would have enjoyed a tax-free status forever,[58] AA would not have gotten any benefit from that status. Any investment made by D,T&I would be worth more as a result of D,T&I's tax position. Rather than pay over the value of its tax position to AA, D,T&I would forego the purchase of AA and make other investments where it would be able to keep the entire value of its tax benefit to itself.[59]

In order to adjust AA's projection, Smith reduced AA's DCF by 50 percent, representing a 48 percent federal tax rate and an average 4 percent state tax with a credit against federal taxes. The GPs added back 4.3 percent of this after-tax figure to account for the investment tax credit. This figure was derived from the

projections for the normalized operation of the IFLs and AA does not challenge its propriety.

3. *Capital Expenditures Needed to Maintain Income*

The final and perhaps most significant difference between DCF and EBIT is that DCF explicitly takes account of the fact that a company may have to make annual capital expenditures in order to maintain earnings. The GPs present a simple example illustrating this point. Suppose there are two companies, A and B, with annual earnings of $100 a year and with no depreciation charges. Capitalizing earnings alone at 10 percent would yield a value of $1000 for both firms. Suppose, however, that company A consumes $30 a year in capital (leaving $70 in DCF) and that company B consumes $80 a year in capital (leaving $20 in DCF)—that is, in order to maintain a $100 a year in income each company has to reinvest $30 and $80 a year respectively. By taking this factor into account, it becomes clear that use of a capitalized earnings approach yields an overly high valuation. Capitalized DCF would be only $700 for company A and $200 for company B.

The illustration in the GPs' brief overstates the importance of this factor, however, since it assumes there is no depreciation. In the real world, depreciation charges against income can serve as a proxy for capital expenditures needed to maintain income.[60] EBIT is an after-depreciation figure. In addition, EBIT includes maintenance of way, another item that can properly be viewed as a capital expenditure required to maintain income. Indeed, it is conceivable that use of EBIT could result in the undervaluation of an enterprise if depreciation and maintenance of way charges exceed capital expenditures needed to maintain income.[61] The advantage of using DCF over EBIT then is not that EBIT ignores the fact that capital expenditures may be required to maintain income but that DCF explicitly includes the factor while EBIT at best includes it indirectly.[62]

While we thus agree with Smith that it is desirable to adjust EBIT to take account of capital expenditures needed to maintain income, we do not completely accept the validity of the adjustments Smith proposes. Specifically, we think that for AA and L&NE, Smith's reduction of EBIT by one-third was inappropriate. Smith derived this figure from the projected normalized earnings statements for the IFLs. Smith found that DCF equalled two-thirds of EBIT for the IFLs and assumed that a similar relationship would hold for AA and L&NE. This assumption was unjustified.

Smith testified that the bulk of his one-third adjustment was accounted for by capital expenditures, the largest part of which is made up of rolling stock. Smith (D) (Aug. 25, 1980) at 2022-34, 19 GP Supp. App. at 374-86; 2 GP at F 19 n.9. AA based its earnings study, however, on the assumption that, save for locomotives, its acquirer would have leased all the equipment it would have needed. And as Smith himself admitted at his deposition, if the "income statement correctly reflected the total amount of per diems payable, then there would be double counting" if the one-third deduction were also made. Smith (D) (Aug. 25, 1980) at 2028, 19 GP Supp. App. at 380. This is because the shortfall in allowable depreciation "will be passed on" by the owner of the car in the rental charges. Smith (D) (Aug. 26, 1980) at 2120, 19 GP Supp. App. at 399. It was improper, therefore, for Smith to reduce AA's EBIT to account for capital expenditures needed to maintain income.[63]

Smith's one-third adjustment is similarly overstated for L&NE. L&NE's witness, Jack Storm,[64] assumed that all new equipment needed by L&NE would be rented. Storm (D) (Mar. 28, 1979) at 46, L&NE App. Accordingly Smith should not have deducted one-third from L&NE's EBIT to arrive at DCF.

EL stands on a different footing. It posited that the acquirer of its lines would have purchased new equipment and would have financed those purchases by issuing equipment trust certificates.[65]

EL deducted interest and principal payments on these certificates to derive what it calls levered cash flow. The GPs' expert testified that the acquisition cost of new equipment should be charged against cash inflow in the year that it was acquired. In order to convert EL's figures, Smith performed a two-step adjustment. First, he added interest and principal payments on new equipment back into the EL's figures. Smith next subtracted the acquisition cost of new equipment. Smith (S) (Jan. 30, 1980) at 24[illegible] *id.* at Ex. GPS-Smith (II)-31. This yields what the GPs call an unlevered cash flow.

At times it has seemed to the court that the parties have argued that one or the other approach was the "correct" one. See, *e.g.*, 2 ELF at 441-42; Smith (S) (Jan. 30, 1980) at 249. The GPs' reply brief and oral argument make it clear, however, that both sides agree that it is proper to use either a levered or unlevered cash flow in valuing an enterprise as long as a debt-to-equity ratio and cost of debt consistent with that assumption is used and that either approach, properly applied, will yield the same result. 1 GPRB at F 56-58; Tr. at 70-73 (EL), 282-86 (GPs). There will be further discussion of the debt-to-equity ratio and cost of debt at pp. 57-59, 65, *infra*. Suffice it to say here that the parties agree that if the effect of equipment financing is accounted for in the cash flow, then the debt-to-equity ratio and cost of debt should exclude equipment debt. Similarly, if an unlevered cash flow is used, equipment debt should be included in the ratio and cost of debt. The choice between levered and unlevered cash flows then boils down to one over the proper debt-to-equity ratio and cost of debt. We opt for the use of unlevered cash flows. This is because, as our full discussion of debt-to-equity ratios will reveal, we accept the GPs' approach to choosing the proper ratio, and the ratios the GPs ask us to consider include equipment obligations. Rather than adjust those ratios, we think it is easier to adopt the GPs' methodology.

The other difference between the approaches of the GPs and EL is that EL capitalized fifth-year earnings while the GPs capitalized fifth-year unlevered cash flow. As already discussed, we think it is preferable to use DCF. EL argues, however, that Smith's use of EL's own projected fifth-year cash flow was improper. Smith calculated the PDV of the first four years' projected unlevered cash flows and added to that the PDV of the capitalized value of the fifth-year's unlevered cash flow. Implicit in this approach is the assumption that fifth-year cash flows represented cash flows for a normalized year. EL argues that this assumption was unfounded. Tr. at 77-78.

Shannon testified that fifth-year *earnings* for EL were normal because by that time the acquirer of EL's lines would have completed its rehabilitation program and would have fully realized the projected savings from merged operations. Shannon made no judgment as to whether fifth-year cash flow, as opposed to fifth-year earnings, represented a normal year's experience. EL claimed that projected fifth-year capital expenditures did not represent the normalized experience because Shannon's replacement schedule for EL's car fleet was based on a 23-year replacement cycle whereas the useful life of this equipment is 28 to 30 years. El concluded that fifth-year equipment acquisition levels are higher than normal and that, therefore, the fifth-year cash flow understates the "normalized" cash flow. *Id.*

Since this argument had not been fully addressed in the briefs, the court in a letter dated June 25, 1981, asked counsel for EL to submit a statement giving more details of and record support for their contentions. EL submitted a statement to the court on July 10, 1981, Sp. Ct. Rep. N 36191, and the GPs responded on July 17, 1981, Sp. Ct. Rep. N 36300. An examination of these statements and the accompanying workpapers reveals that Shannon did not assume an accelerated replacement program. Instead, he explicitly assumed that a normal schedule would require the annual replacement of 4 percent of the EL's total car fleet. This

translates into a 25-year replacement cycle, a schedule comparable to the projections made by other witnesses. Smith was perfectly justified, therefore, in treating the fifth-year cash flow as representing a normal year's experience.

B. *Discount Rate*

In the previous discussion, we have frequently alluded to an "appropriate interest rate". Not surprisingly, the parties differ as to what that rate should be. The GPs' lead witness on the subject, Smith, opined that the proper rate would be 10.66 percent assuming a July 1, 1974, disposition and 10.45 percent assuming an April 1, 1976, disposition. EL's witness, Percy Young, Jr.,[66] applied a 6 percent discount rate to the first four years' DCF and capitalized fifth-year earnings at 10 percent.[67] AA's witness, Laurie, used a 7.5 percent capitalization rate[68] and Storm, L&NE's witness, used a 10 percent rate. Neither Laurie nor Storm, however, gives any justification for his choice of interest rate.[69]

The witnesses who did give detailed consideration to this question, Young for EL, Smith, Dr. Richard Roll,[70] and Dr. Richard Meyer[71] for the GPs, and Paul Hallingby, Jr.[72] and Dr. Stewart Myers[73] for PC agreed that the appropriate interest rate for discounting DCF could be derived by calculating the average weighted cost of capital (AWCC). AWCC is made up of three components: cost of equity, cost of debt, and debt-to-equity ratio. Calculation of AWCC requires an average of the cost of debt and cost of equity, weighted by the percentage of debt and equity in the capital structure. So, for example, if the cost of debt is 5 percent and cost of equity is 10 percent and debt comprises 50 percent of the capital structure, AWCC is 7.5%—$(.5\times.05)+(.5\times.10)$.[74]

Cost of debt and cost of equity are both made up of three factors—the risk-free rate of interest, an inflation component, and a premium compensating the investor for risk. The risk

component is the only one unique to each enterprise, however. Risk is essentially an assessment of the likelihood that the true outcome will differ from the expected outcome. So, for example, if there are two investments that are both expected to generate a DCF of $10 a year on average, but one is expected to have a constant return and the other a variable return, the second investment would be considered riskier. Given a choice between the two investments with the same price, a rational investor would chose the one with the more predictable yield. In order to induce an investor to purchase the riskier asset, its purchase price must be lower than that of less risky assets with the same DCF. A lower purchase price translates into a higher rate of return on the riskier asset. The degree of risk also affects the debt-to-equity ratio—the greater the risk, the less debt the company can carry and still maintain the same cost of debt.

The Ts' witnesses testified that a purchaser of the proffered lines would view the investment as having the same level of risk as an investment in an average risk security. The GPs' witnesses testified that an investment in the Ts' properties would involve a greater than average amount of risk. On balance, we consider that the conclusion is almost inescapable that a purchaser of the Ts' lines would have viewed the investment as having a greater than average amount of risk. We believe, however, that the GPs' witnesses overstate the risk premium associated with an investment in the Ts' lines. Accordingly, we have no choice but to discuss each of the three components that make up AWCC and derive our own discount rate.

1. *Debt-to-Equity Ratio*

The first component we consider is the debt-to-equity ratio because the cost of debt and the cost of equity both depend on that number. The relationship between the debt-to-equity ratio and the cost of debt and equity is a simple one. Debt is generally cheaper than equity for two reasons. First, because bondholders

have first claim on the assets of the company, there is less risk that, in liquidation or reorganization, bondholders will not recoup their investments with interest. Second, because interest payments are tax deductible, the effective cost of debt is reduced to the company.

One might think, then, that the optimal strategy would be for a company to reduce its total cost of capital by weighting its debt-to-equity ratio heavily in favor of debt. There are two limits to this however. First, as the percentage of debt in the capital structure increases, so does the probability that the company will not be able to meet its interest and principal payments. The probability that bondholders will not recoup their investment in the event of liquidation or reorganization also increases. The increased riskiness of the debt translates in the marketplace to a higher interest rate so the cost advantages of debt tend to disappear as the proportion of debt in the capital structure increases.

The riskiness of equity investment also increases as the debt-to-equity ratio goes up. Since a stockholder's interest is in the cash generated by the enterprise after bondholders have been paid, the greater the percentage of debt the greater the volatility in the stockholder's interest. To illustrate, assume two companies are expected to generate DCF of $100 a year. Company A has no debt, Company B is 80 percent debt financed, and pays $80 a year to bondholders. If actual earnings are 10 percent less than expected, the shortfall to an equity investor in Company A from his expected return is also 10 percent. But for an equity in Company B, the shortfall is 50 percent—he expected $20 and received only $10. The same phenomenon occurs on the upside as well—an unexpected 10 percent increase in earnings results in an unexpected 50 percent gain to equity investors in Company B.

In selecting a debt-to-equity ratio, the witnesses uniformly start with the average ratio for railroads as a group. Roll, the GPs' witness, testified that based on book value for all five samples of railroads he examined, railroads in the mid-1970's were financed with roughly 40 percent debt and 60 percent equity.

Roll (S) (Jan. 30, 1980) at 112. Smith determined that railroads that had A-rated senior mortgage debt from 1966-75 generally maintained ratios of debt to total capitalization of 30-35 percent. Smith (S) (Jan. 30, 1980) at 80-81. Stewart Myers, a witness for PC, estimated that the average debt ratio for ten large railroads making up the S&P 10-railroad index from 1969-74 was about 45 percent. Myers, however, calculated this debt ratio using estimated market values of equity and debt rather than book values. All the witnesses included equipment debt in their ratios. Our first step, then, is to choose between book- and market-valued ratios.

Stewart Myers states flatly that "the relevant measures of the debt and equity proportions are the market values of debt and equity." Myers (S) (Dec. 1, 1978) at App. C-1. No further justification is given. However, Smith tells us that bond rating agencies primarily rely on book values. It seems likely, therefore, that an acquirer of the Ts' lines would have made its capitalization decision on the basis of book valued debt ratios of comparable lines. Smith (S) (Jan. 31, 1979) at 36.[75]

Assuming that book-valued ratios are the relevant figures, we must still choose a number. We believe that Smith made a convincing case for the use of a 30 percent debt ratio. Smith based his argument on the assumption that an acquirer would have sought an A rating on its senior mortgage debt. Smith thought that there would be two related advantages to an acquirer in seeking an A rating. First, he noted that debt rated at less than an A rating was far more difficult to market than higher rated bonds at the relevant times. In turn, this difficulty became reflected in the interest rates investors demanded. See Smith (S) (Jan. 30, 1980) at 143-44. Since the A-rated railroads that Smith examined had a book valued debt ratio of 30-35 percent including equipment obligations, and since the Ts' lines would have been viewed as riskier than a typical A-rated road, an assumption with which we agree, see pp. 62-65, *infra*, Smith concluded that an acquirer would have used a debt ratio at the

low end of this range. See Smith (S) (Jan. 30, 1980) at 80-83. For the purposes of our analysis then, we will assume that acquirers of the Ts' lines would have ultimately financed their acquisitions using 30 percent debt and 70 percent equity.[76]

2. *Cost of Equity*

In estimating the cost of equity three factors must be considered: the rate of return demanded by investors for average-risk stocks, the riskiness of railroad stocks relative to average-risk stocks, and the riskiness of an equity investment in the Ts' lines relative to railroad stocks. We will refer to the two additional risk factors as railroad risk and special risk. There is rough agreement among the experts on the rate of return on average-risk investments. The GPs' witness, Smith (S) (Jan. 30, 1980) at 61, and PC's witness, Myers (S) (Dec. 1, 1978) at 29-34, both relied on a study performed by Ibbotson and Sinquefield[77] which found that, for the period from 1926 to 1976, the real rate of return for the Standard & Poor's index of 500 stocks was 9.2 percent.

The experts disagree over whether an investment in the Ts' lines would be viewed by a purchaser as entailing a greater than average risk. Smith concluded that railroad stocks as a group involve greater than average risk and that an investment in the Ts' lines in particular would involve still greater risk. He stated that the Ts' lines should be assigned nominal costs of equity ranging from 20 to 25 percent.[78] For valuation purposes, he settled on the average, 22.5 percent, as the nominal cost of equity as of April 1, 1976, which translated into a nominal cost of equity of 21.98 percent as of July 1, 1974.[79] The Ts' witnesses testified that investment in the Ts' properties would not be viewed as entailing any additional risk.

Smith did not quantify how much of his additional risk premium consisted of railroad and how much of special risk. Nonetheless, by examining the arguments and statistical evidence offered in support of Smith's conclusion that an investment in the Ts' properties would involve both railroad and special risk we can come to a judgment as to the reasonableness of Smith's conclusion and as to what the proper discount rate should be.

(a) *Railroad Risk*

Smith enumerated a long list of factors supporting his conclusion that investment in the railroad industry is riskier than investment in an average-risk industry. He stated that:

> the returns earned by railroads are impacted to a greater extent than most businesses by a combination of factors beyond their control, including economic cycles, inflation, government transportation policy and regulation . . . competitive considerations, capital intensiveness, labor intensiveness, and adverse weather.

Smith (S) (Jan. 30, 1980) at 45-46. Whatever the merit of Smith's judgments as to the respects in which railroads are riskier than average,[80] Smith also admitted that in numerous respects railroads were less risky than average. For example, Smith admitted that railroads are essentially immune from the risks associated with dealing directly with consumers or with being in a field with rapid technological change. See 2 ELF at 420-21. Simply as a matter of judgment, then, it would seem to be a very difficult task to weigh all the relevant factors and state confidently that an industry is more or less risky than average.

This is one area, however, where the court need not rely solely on an expert's personal judgment. Statistical analysis is available and was offered by the parties to determine whether railroad

stocks as a group have historically yielded higher rates of return to compensate investors for higher than average-risk. The parties have generally avoided heavy reliance on this material in their briefs for fear of burdening the court with the detailed and admittedly technical debate among three experts which spans four volumes of testimony. Likewise, we will not encumber this opinion with a lengthy discussion of this evidence.

Briefly, PC's witness, Stewart Myers, estimated two commonly used measures of risk, standard deviation of the annual rate of return and beta, for a representative sample of large railroads. Beta measures the amount of risk which a stock contributes to a portfolio made up of a large number of stocks. Both measures showed that railroad stocks were average-risk investments. The GPs' witnesses offered several criticisms and refinements of Myers' study. None of this evidence gives us any reason to question Myers' conclusions.

The GPs' witness, Roll, proposed another measure of riskiness which he called "excess return", and estimated that railroad stocks commanded a 6.14 percent premium over average risk stocks for the 1969-74 period. In essence, excess return is the difference in risk premium between an average-risk stock and the stock or stocks being studied. But Roll's estimates of excess returns were not statistically significant—that is, one could not say to an acceptable degree of certainty that Roll's findings were not attributable to random fluctuations. And their values varied widely depending on the period studied, so much so that for the years 1964-69 excess returns were negative. In sum, despite their impressive efforts, Roll and Richard Meyer have failed to develop evidence which would lead us to reject Myers' initial conclusions.

(b) *Special Risk*

While we reject the GPs' contention that railroad stocks as a group are relatively risky investments, there can be no doubt that,

as the GPs' brief puts it, "[b]oth the record and simple common sense", 1 GPRB at E 79, indicate that potential acquirers of the Ts' lines would have viewed such investments as being of above average risk. However, we believe that Smith overstated the special risks attending the Ts' properties.

Smith initially made his risk assessment for the IFLs and went on to assume that the Ts' properties were equally risky, see note 78, *supra*. In reviewing the three major reasons he gave for the IFLs' special risk the court is convinced that, although the Ts' properties share the same characteristics that contributed to the IFLs' peculiar riskiness, Smith's blanket conclusion that the Ts' lines were as risky as the IFLs was unfounded.

The first factor Smith identified is that the Ts' properties were all located in the Northeast. Smith argued with considerable force that:

> . . . Class I railroads in the Northeast on average were characterized by less favorable operating margins, lower returns, less growth and less financial resiliency than observed elsewhere in the industry. . . . Rail operations in the Eastern District (roughly, the Northeast region) were particularly vulnerable to competition from the trucking industry, and were characterized by relatively higher terminal costs, shorter average lengths of haul, and higher labor costs than rail operations elsewhere in the country. These factors contributed to an increased volatility of railroad financial performance. . . .

Smith (S) (Jan. 30, 1980) at 46-47. But, as the transcript of his deposition reveals, Smith (D) (Aug. 21, 1980) at 1624-27, EL App. J at 337-40, when Smith said "railroads in the Northeast", he meant bankrupt railroads in the Northeast. The financial performance of Norfolk & Western, C&O, and B&O all compare favorably with Western and Southern railroads. Smith argued, however, that the profitable Eastern carriers as a group were not

comparable to the bankrupts. For example, he stated that the Norfolk & Western and C&O were heavily into transporting coal, a service which is virtually immune from trucking competition. Smith (D) (Aug. 21, 1980) at 1625, EL App. J at 335. And as Smith points out, there is no getting around the fact that at that time the major railroad bankruptcies had occurred in the same region and that this supports an inference that railroads operating in the Northeast shared common problems.[81] Saying this, however, does not mean that all the Ts would be viewed by potential acquirers as suffering from these problems to the same extent as PC.

This difference is highlighted by the next factor Smith cites. He claims that potential acquirers would view investment in the Ts' properties as particularly risky because the railroad industry in the Northeast would be radically reconfigured in an attempt to overcome all of the problems previously discussed. Again, to a certain extent, Smith is correct. Even without the uncertainties introduced by the creation of the JTs, the transformation would have been striking. Approximately one-third of the combined trackage of EL and LV would have been abandoned. New owners, new routings and new competitive relationships would have all contributed to the ensuing uncertainty. But while the restructuring of EL's and LV's lines would have been considerable, it pales in comparison to that envisioned for PC. In the alternative scenario, PC posited that 16,000 miles out of its 26,000-mile system would have been abandoned. The scope of the adjustments necessitated by PC abandonments would have been far greater than those for the other Ts. Smith admitted at his deposition that "Erie was just, on a raw basis, in terms of mileage, not be reconfigured to the same extent, as certainly the IFL." Smith (D) (Aug. 8, 1980) at 757-58, EL App. J at 165-66. And the complexities and uncertainties attendant on the restructuring of a 26,000-mile system cannot be compared to the simple single-line proffers made by AA and L&NE.

To be sure, Smith correctly points out that wholly apart from uncertainties created by the restructuring of their own lines, the extensive abandonments and restructuring of PC's lines would have created problems for the purchasers of the other Ts. But this factor cuts both ways. Laurie, EL's witness on traffic, projected that while EL would lose 17,000 cars annually due to PC's abandonments, EL would gain over 50,000 new cars. Laurie (S) (Dec. 30, 1978) App. 1 at 4.

Finally, Smith reasoned that potential acquirers would assign a higher discount rate to the Ts' lines because "property with which a potential purchaser railroad does not have significant experience or any historical reference point—will be treated with less confidence." 2 GP at F 54. Again, we accept Smith's general proposition but do not believe that the Ts' lines stand on the same footing as the IFLs. As EL and AA point out, in contrast to the IFL case their projections are based on verifiable historic traffic and cost data. While potential acquirers of the Ts may not have had significant first hand operating experience with those lines, this does not mean that all projections would have been viewed as having the same inherent unreliability.[82]

One benchmark we have not yet considered is the costs of equity that Smith actually employed in his valuation of five other rail acquisitions conducted at various times from 1976 to early 1980. The average rates he has used ranged from 16.5 percent to 19 percent. Although EL argues that we should reject this testimony because of Smith's failure to give significant details about how those numbers were derived, see ELRB 159-62, keeping these numbers in mind gives a feel for what real world numbers are like.

The court is left then with the difficult task of choosing a discount rate based on an informed judgment as to what factors to consider and as to the riskiness of the Ts' lines relative to the IFLs. The range we consider runs from 16 percent, the rate of return on average-risk equity investments, to 25 percent, the highest rate considered by Smith. We do not think it worthwhile

to attempt to derive different rates for different Ts since, all things considered, we do not think we will find much to distinguish them. While AA and L&NE may have the simplest proffers, Smith points out, Smith (S) (Jan. 30, 1980) at 293, that their small size creates an entirely different set of risks. And relative to AA and L&NE, the EL-LV package has neither any particularly positive nor negative factors. To be sure, no number which we choose will be "correct" since we are making a subjective judgment as to what the subjective judgment of a potential acquirer would have been. On balance, however, we think that 20 percent is a reasonable estimate of the cost of equity for the Ts' lines as of January 1, 1974, assuming 30 percent debt financing.[83]

3. *Cost of Debt*

The final component in determining AWCC is the cost of debt. As previously discussed, the 30 percent debt ratio that we have used assumes that senior mortgage debt would be A-rated. According to Smith, senior mortgage debt would make up one-third of the total debt. The other two-thirds would be made up of equipment trust certificates. The certificates would be Aa-rated. Equipment debt is generally rated one grade higher than senior mortgage debt because it is better secured and because it receives favorable treatment in bankruptcy. No witness provided us with estimates of what the yield on railroad bonds would have been.[84] However, we do have two tables prepared by the GPs' witness Roll, Roll (S) (Jan. 30, 1980) at 87, 97, which show the yields of various railroad bonds. The tables show that on January 15, 1974, Burlington Northern issued A-rated, non-convertible senior mortgage debt with a yield of 8.6 percent and that on the same date, Norfolk & Western issued Aa-rated equipment trust certificates yielding 7.9 percent. We believe that a prospective acquirer would have viewed these as reasonable estimates of their cost of debt capital. Taking a weighted average of these rates gives us an 8.13 percent pre-tax cost of debt as of January 1, 1974.

Only one further adjustment needs to be made. The cost of debt which we have so far discussed is pre-tax. However, since interest payments are tax deductible, the relevant measure is the after-tax cost of debt. All of the witnesses who have considered this have assumed a 50 percent marginal tax rate and have accordingly reduced the cost of debt by one-half.

4. *Calculating AWCC*

We now have all the necessary ingredients. The table below shows how AWCC for January 1, 1974 is computed.

AWCC as of January 1, 1974

Weighted cost of equity		*Weighted after-tax cost of debt*		*AWCC*
(20 x .70)		(4.067 x .30)		
	+		=	15.22
14		1.22		

The AWCC which we have so far calculated is stated in nominal terms. The cash flow projections are stated in constant dollars. We therefore need to factor out the inflation component from the rates. Using Smith's assumption of a 5.58 percent long term inflation rate for 1974, Smith (S) (Jan. 30, 1980) at 54, we derive a real AWCC of 9.13 percent as of January 1, 1974.

VIII. Rehabilitation Costs and Maintenance of Way Expenses

The GPs and each T provided estimates for the rehabilitation costs (RC) and annual maintenance of way expenses (MOWE) necessary to restore and maintain the properties they proffered for continued rail use. The GPs obtained their estimates from a study conducted expressly for this litigation by Sverdrup & Parcel and Associates, Inc. (S&P), consulting engineers.[85] The Ts obtained their estimates from studies conducted in-house, studies

by outside consultants, and studies by potential acquirers. That the methodologies of the various studies differ markedly is not surprising. What is surprising is the extent to which the results differ.[86]

The differences in method between S&P's study and the various studies of the Ts are too substantial to allow us to compare the studies item by item and to extract a composite figure for RC and MOWE that melds the results of each. Rather, we have examined each study individually to determine its reliability in the light of the shortcomings pointed out by its opponents, with a view toward selecting the more reliable study and adjusting it for whatever errors are uncovered. For the reasons set out below, we conclude that the GPs' study does not withstand scrutiny. We therefore accept the studies submitted by EL, LV, and AA as the starting point for deciding the RC and MOWE expenses facing the potential acquirers of those Ts' lines.

A. *The Government Parties' Study*

The methodology employed by S&P in conducting its study is detailed extensively in two multivolume reports prepared by S&P and introduced in evidence by the GPs. See Rehabilitation Study for United States Railway Association, January 31, 1979 (1979 Study), and Rehabilitation and Maintenance Study for United States Railway Association, January 30, 1980 (1980 Study).[87] The two principal architects of the S&P Studies were H. Porter Morgan, who was in charge of all track related items, and Roy Gunderson, who was in charge of bridges and tunnels. Both Morgan and Gunderson had extensive experience in railroad maintenance.[88]

Morgan and Gunderson began by dividing the Ts' rail facilities into four major categories—track, bridges, yards, and signals. Drawing upon a variety of sources, see 1979 Study at III, they developed standards and criteria to be used in defining the level to which these rail facilities should be restored and maintained.

Morgan and Gunderson then set out to determine the condition of the Ts' lines as they existed in 1974. Because they did not begin their study until four years later, any new data they could have collected concerning the condition of the railroads would have had to be adjusted to account for the deterioration that occurred and the maintenance and rehabilitation that was undertaken in the intervening years. Rather than undertake this difficult and uncertain process, they obtained their raw data from a study, commonly known as the Bechtel Study, which was commissioned by the USRA during its preparation of the FSP and which was conducted in 1974 and 1975. The data generated for the Bechtel Study were obtained from inspections, interviews with key railroad personnel, maintenance charts, and other company records.

Extrapolating from this Bechtel Study data, Morgan and Gunderson attempted to assess the condition of each T's lines. They determined how much work was necessary to restore the lines to the levels dictated by the standards they had developed, and defined these rehabilitation requirements in terms of units called "work functions".[89] Morgan and Gunderson also developed unit cost figures for each work function. Straightforward calculations based on their projections for the total number of units of work needed and the costs attributable to those units of work yielded RC figures for each proposed acquisition hypothesized by the Ts in the alternative scenario. A similar set of calculations based on projected annual maintenance needs yielded a corresponding set of annual MOWE figures. See H. Morgan Corrections (S) (June 6, 1980) at Tables VIII-2aA, VIII-2bA.

The S&P methodology is not inherently weak. As applied, however, it yielded questionable results. In three of the four major areas of rehabilitation studied by the S&P team—track, bridges, and yards—sampling errors, incorrect use of standards, and inaccurate data undermined the reliability of S&P's results.

Appendix H

1. *Track*

With one exception, S&P's estimates for track rehabilitation constituted the largest portion, in some cases over 50 percent, of every T's total RC. See 2 GP at E 10-11. The Ts catalogue numerous errors in the methods S&P used in making its estimates of track rehabilitation. The asserted errors relating to three portions of the track study—rail replacement, turnouts, and crossings—bear detailed discussion.

(a) *Rail Replacement*

Just as track rehabilitation generally constituted the largest portion of each T's total RC, rail replacement constituted the largest single item of track rehabilitation.[90] For the reasons explained below, Morgan overstated the rail replacement needs of the Ts.

i. *Vertical Headwear.* Headwear refers to the wear to the surface of the rail that comes in contact with a train's wheels. Although this surface of the rail wears both horizontally, affecting the width—or gauge—of the rail, and vertically, the controversy over headwear in this case is confined to vertical headwear. The rate of headwear depends primarily on the speed and weight of the traffic that runs over it. When the headwear on rail used in heavy, high-speed traffic reaches certain levels, considerations of safety and economics demand that it be removed and relaid in areas of lighter use, such as secondary lines, branch lines, and yards.[91] In making his rail replacement decisions, Morgan relied on a table of headwear standards developed by the American Railway Engineering Association (AREA).[92] Morgan misapplied these AREA standards, however, in three important respects.

Morgan's first error concerns his interpretation of the AREA figures. The AREA table sets out four classes of use for rail: main line (Class I), branch line (Class II), light branch line

(Class III), and yards (Class IV). For each class, the table assigns figures for maximum allowable headwear, both vertically and horizontally, for various weights of rail.[93] For example, the table sets out the following figures for maximum vertical headwear on 140-pound rail:

Class I	¼ inch
Class II	⅜ inch
Class III	⅝ inch
Class IV	¾ inch

1979 Study at III 30.

Morgan interpreted the AREA table to mean that as headwear on the Ts' rails in each class approached the allowable figures, it should be removed and relaid in the next lower class.[94] Thus, as Morgan interpreted the table, 140-pound rail in Class I use should be removed and relaid in Class II use when the headwear approaches ¼ inch; rail in Class II service should move to Class III service when headwear approaches ⅜ inch. This interpretation and application of the AREA standards is directly opposed to the views of other railroad engineers. When the Bechtel Study was completed, Bechtel had a group of six railroad engineers review and assess the work of the various engineering firms who had done the leg work for the study. Those engineers had this to say about the AREA table:

> [T]he table actually recommends the limits of rail wear for various classes of service at which it is economically feasible to remove bolted rail from track, weld it and replace it in track of the same class service rather than requiring removal from track to a lesser class of service.

H. Morgan (D) (May 7, 1980) Ex. 109, EL App. E at 198. Under this interpretation of the table, even if the table is used as a guide for determining when to remove rail, a purpose for which it was not intended,[95] Class I rail can still be economically relaid in

Class I service as wear approaches ¼ inch; it is not until wear exceeds ¼ inch that relaying in Class I service becomes uneconomical because its useful life would be too short. Indeed, if Class I rail is destined for Class II service, the table indicates only that for economic purposes the rail need not be removed from Class I service until wear approaches ⅜ inch.

The GPs make no attempt to defend Morgan's interpretation of the AREA table. Nor do they quarrel with the Bechtel consultants' explanation of the proper use of the table. See 3 GPRB at App. A 41-42. Instead, the GPs' line of defense is that Morgan did not make rail replacement decisions solely on the basis of headwear; headwear was but one of a number of factors considered. Nevertheless, Morgan and one of the two assistants assigned to making rail replacement decisions admitted that headwear was a major factor in making those decisions.[96] See H. Morgan (D) (Apr. 14, 1980) at 201-02, 216, 28 GP Supp. App. at 6-7, 14. By analyzing a major factor like headwear under standards that were more strict than those used in the industry, Morgan and his assistants would have replaced rail prematurely, thereby inflating the cost of rehabilitation.

The second way in which Morgan misapplied the AREA table was by misclassifying the Ts' lines. The AREA table sets out four classes of track use. The table gives no guidance, however, in determining the appropriate classification for a particular rail line. Morgan used traffic density, measured in millions of gross tons per year (MGT), as the determinant. Using traffic density to classify railroad lines is an acceptable practice. The problem arises from the density figures Morgan chose. Morgan classified the Ts' lines as follows:[97]

Class I	10 or MGT
Class II	1 to 9.9 MGT
Class III	0 to 0.9 MGT

1979 Study at III-32. In contrast, given the speed limits on the Ts' lines, the Bechtel Study used the following classification:

Class I	20 or more MGT
Class II	5 to 19.9 MGT
Class III	0 to 4.9 MGT

ELF at 163; H. Morgan (D) (May 7, 1980) Ex. 108, EL App. E at 187. As is obvious from a comparison of the two tables, Morgan's scheme places track between 10 and 19.9 MGT and track between 1 and 4.9 MGT in higher classes than they were placed in Bechtel's scheme. Since headwear standards become more strict as the class of service increases, Morgan's classification subjects all the Ts' lines within those density limits to more restrictive headwear standards than would be the case under Bechtel's classification. The inevitable result is that more rail replacement is called for under Morgan's approach than that of Bechtel.

On the record before us, we cannot definitively say which is the correct classification scheme since the AREA does not set out the densities for its classifications. For several reasons, however, we conclude that Morgan's figures are too conservative. First, the Bechtel Study was performed by disinterested parties for the FSP. Second, the Bechtel classification scheme was specifically approved by Chessie engineers who made their own independent study of the rehabilitation needs of some of the Ts' lines. Chessie System Preliminary Engineering Plan for Selected Property Acquisitions of Erie Lackawanna, Penn Central, Reading (Chessie Study), EL App. B at 211. Morgan in contrast offered no support, other than his own expert judgment, for the reasonableness of his classifications.

The third problem with Morgan's application of the AREA tables is his use of inaccurate data concerning the actual density of traffic on a number of the Ts' lines. For example, Morgan

assigned excessive densities to 13 of the 27 EL lines in the Western acquisition for which he had inspection data.[98] See 1 ELF at 169 & n.132. According to the GPs' own estimates, more than 27 percent of the rail replacement in the EL Western acquisition in Morgan's study occurred in lines where densities were overstated. 3 GPRB at App. A 49. Morgan admitted that 280 of the 390 miles of LV track he would replace were on lines where correction of his density errors would have reduced the applicable AREA classification. H. Morgan (D) (Aug. 13, 1980) at 4026, EL App. D at 469. Although Morgan contended that correcting the densities would not have had a significant impact on his rail replacement decisions because headwear was but one factor, H. Morgan (D) (Aug. 13, 1980) at 4026-27, EL App. D at 469-79, he had no basis for that opinion because he did not know how many rail replacement decisions he would have had to change. Indeed, he could not know without reanalyzing those miles of track, H. Morgan (D) (May 5, 1980, Aug. 13, 1980) at 2571-72, 4027-28, EL App. D at 56-57, 470-71, something he did not do. By classifying substantial portions of the Ts' lines in higher classifications than they belonged, Morgan derived rail replacement figures that were too high.

ii. *End Batter and Mismatch.* "End batter" and "mismatch" were two of the other factors Morgan and his assistants relied on in making rail replacement decisions. End batter is the deterioration of the ends of bolted rail, and mismatch is a difference in height between the ends of two abutting lengths of rail. Morgan adopted generally accepted standards published by the Federal Railroad Administration (FRA), which assign the maximum allowable limits for these two types of wear depending upon operating speed. Morgan's team would have replaced or repaired rail that exceeded one half these FRA limits. 1979 Study at III 40.[99]

As with his density classifications, Morgan's FRA speed classifications for a number of the Ts' lines were incorrect. For example, over 900 miles of EL track in the Western acquisition were misclassified. See H. Morgan (D) (Aug. 13, 1980) at 3988-4008, 4014-15, EL App. D at 431-51, 457-58; 1 ELF at 196 & n.157. By the GPs' own calculations, almost 38 percent of the rail to be replaced in the EL Western acquisition was located in lines where the speed class was too high. Again, Morgan was unable to state how much his rail replacement decisions would have been affected had he classified the lines properly. Nor did he attempt to reanalyze those decisions after these errors were pointed out, H. Morgan (D) (Aug. 13, 1980) at 4016, EL App. D at 459, even though he made adjustments in some of his other calculations to take account of these errors. H. Morgan Corrections (S) (June 6, 1980) at 7. As in the case of the density errors, misclassifying the rail as to operating speed subjected the rail to higher standards than necessary and therefore inflated rail replacement needs.

There were other errors in Morgan's study that increased rail replacement estimates. For example, his study called for the replacement of rail on nonexistent lines and on lines where maintenance was conducted by railroads other than the Ts. 1 ELF at 183-84. We could perhaps adjust those errors. The four major errors detailed above, however, cannot be corrected without redoing the study line by line. Those errors substantially overstated the Ts' rail replacement needs.[100] A comparison of Morgan's estimates for rail replacement with the figures proposed by the Bechtel Study reinforces that conclusion. For EL and LV, Morgan called for the replacement of between 40 and 60 percent of the rail on the proffered lines; the Bechtel Study, on the other hand, called for replacement of only 7 percent. See 1 ELF at 157.[101]

Appendix H

(b) *Turnouts and Crossings*

Turnouts are switches that divert trains from one line of track to an adjoining line. Crossings are the points where a rail line intersects with either another rail line or a highway. S&P's estimates for the cost of rehabilitating the Ts' turnouts and crossings are not as large as its estimates of rail replacement costs. The figures are nevertheless substantial.[102] The methodological shortcoming that undermines these figures is the use of questionable sampling techniques for obtaining data on the condition of these items.

The sampling technique recommended by the Bechtel Study called for obtaining data from 10 percent of all the Ts' turnouts except yard turnouts. The sample turnouts were to be randomly selected and evenly distributed over the Ts' lines. See 1 1979 Study App. at III-1-15. Morgan admitted, however, that the Bechtel data he relied on did not meet the recommended 10 percent sampling rate. On the EL and LV acquisitions, his samples ranged from only 3.3 to 5.9 percent. H. Morgan (D) (Apr. 30, 1980) at 2405-09, EL App. D at 15-19. Moreover, the sampled turnouts were not evenly distributed over all EL and LV lines; some lines were entirely unrepresented, while as many as 33 percent of the turnouts on other lines were used in the sample. H. Morgan (D) (Apr. 30, 1980) at 2409-17, EL App. D at 19-27.

The S&P RC estimate for the highway crossings of at least one T, LV, is based on an even more questionable sampling technique. Data were available on only three of an estimated 329 highway crossings on LV lines in one of the EL-LV acquisitions. All three were located on a branch line. The Bechtel Study had determined that they should be replaced. On the basis of that sample, and the Bechtel Study's recommendation, Morgan decided to replace all 329 crossings. See H. Morgan (D) (Apr. 30, 1980) Ex. 67, EL App. E at 90-91. Morgan later conceded that this was not a reliable sampling method. H. Morgan (D) (Apr. 30, 1980) at 2472-73, 28 GP Supp. App. at 228-29.

The meager nature of these samples, both for turnouts and for highway crossings, as well as the willingness to rely on such limited data in assessing substantial rehabilitation sums to the Ts, does not inspire confidence in the accuracy of the S&P estimates, and indeed indicts the S&P Study in general. That these sampling problems introduced errors in favor of the GPs is confirmed by a comparison of S&P's estimate for these items with the numbers generated by a potential acquirer that had no motive to understate costs. Chessie estimated that turnout replacement on the EL lines in the Chessie acquisition would cost $326,100. Chessie Study, EL App. B at 221. In contrast, the S&P estimate was almost $6 million before salvage credit. H. Morgan (D) (Aug. 22, 1980) Ex. 280, EL App. E at 278-80 (Proffer Code 83). Chessie's estimate for highway crossings was $400,000, EL App. B at 221, while S&P's was over $3 million. H. Morgan (D) (Aug. 22, 1980) Ex. 280, EL App. E at 280.

2. *Bridges*

Gunderson headed the S&P team in charge of producing bridge RC estimates on the Ts' lines. The Ts launch a broad attack on the methods and results of these estimates, illuminating errors in all phases of the study. We find it necessary to focus on only one error in reaching our conclusion to reject the S&P estimates.

Like Morgan, Gunderson obtained virtually all of his data from the Bechtel Study. Gunderson (S) (Jan. 30, 1980) at 24-25. The six engineering firms hired to do the Bechtel Study conducted inspections of sample bridges[103] and completed for each bridge a standardized form that listed 90 or more bridge features to check for needed repairs. See 1 1979 Study App. at IV-2-8 to 13. The inspectors also took extensive photographs and conducted interviews with railroad personnel but Gunderson and his team relied

only on the information in the field forms. Gunderson (D) (May 14, 16, 1980) at 175-77, 578-79, El App. F at 29-31, 70-71.

The bridges in the sample were divided into three groups according to construction material: steel, masonry, and timber. The lengths of the bridges were added together to obtain the total number of bridge track feet (BTF) falling in each category. Relying on the information found in the field forms, Gunderson and his staff then placed each sample bridge into one of three possible repair classifications: no repair, light repair, or heavy repair. For example, Gunderson determined that, of the total BTF in steel bridges, 30 percent needed heavy repair, 65 percent needed light repair, and 5 percent needed no repair. 1979 Study at IV 25-27. To determine the bridge rehabilitation needs of each individual T, Gunderson took the total inventory of that T's BTF in each bridge category, and applied the repair percentages he had gleaned from the sample. Assuming EL had 1,000 BTF of steel bridges, 300 BTF would be deemed to need heavy repairs, 650 BTF to need light repairs, and 50 BTF to need no repairs. See generally 1979 Study at IV 20-27; 2 GP at E 57-87.

To transform these repair percentages into dollar amounts, Gunderson developed a work function for each bridge category and repair classification. The work function was simply a standardized repair cost for each classification. For example, Gunderson developed a standard cost per BTF for light repairs on steel bridges, a standard cost per BTF for heavy repairs on masonry bridges, and so on. The final step was to multiply the total BTF in each repair category by the applicable cost figure.

The fatal flaw in Gunderson's study is that the sample from which he drew his data lumped together bridges of all the Ts. Therefore, his data and conclusions reflect, if anything, the average condition of all the bridges conveyed by the Ts. For the purposes of deciding the rehabilitation needs of any individual T, however, the statistics are meaningless without proof that the bridges of all the Ts had fallen into the same state of disrepair. There is no credible evidence to support that assumption. A valid

study of this nature should have been based on separate samples for each T with separate repair percentages for each T. Indeed, this was the original approach adopted by the S&P team, but it had to be abandoned because of a scarcity of data for some of the Ts' lines. Gunderson (D) (May 19, 1980) Ex. 27, EL App. G at 203-4; *id.* at 672-76, EL App. F at 72-76; 3 GPRB at App. A 30-31.

In defense of his decision to lump all the Ts' bridges together rather than obtain repair percentages for each separately, Gunderson cited several reasons to support the assumption that the bridges of all the T's had fallen into the same state of disrepair. He pointed out that all the Ts were bankrupt, that the bridges were all subject to comparable climatic conditions, and that Ts all carried comparable commodities and loads on their lines. In addition, he stated that his impression that all the Ts' bridges were in comparable states of disrepair was partly based on conversations he had had at conventions with professional associates familiar with the Ts' maintenance practices. None of these justifications offer very firm ground for his assumption. That all the Ts were bankrupt offers only weak support for Gunderson's assumption, and even that support is undercut because the Ts went bankrupt at different times—some as early as 1967, others as late as 1972. If bankruptcy is indeed an indicator that maintenance is being deferred, then the length of time a railroad is in bankruptcy would indicate how long, and consequently how much, maintenance has been deferred. Gunderson himself admitted that, as to the EL, which went bankrupt in 1972, the fact of bankruptcy would not weigh very heavily as an indicator that EL's bridges were in the same state of disrepair as the other Ts' bridges. Gunderson (D) (May 21, 1980) at 1107-10, EL App. F at 187-90. The second and third reasons—comparable climatic conditions and comparable loads—may have something to do with the rate at which railroad bridges deteriorate with use, but have little to do with whether, and at what rate, a particular

railroad chooses to defer maintenance on its lines. Casual conversations at conventions could give one a reasonable basis for assuming that the Ts' bridges were falling into disrepair, but they are not a basis for concluding that all the Ts' bridges had fallen into the same state of disrepair.

Not only is there a paucity of support for Gunderson's assumption concerning the similarity in condition of the Ts' bridges, but the data in the Bechtel Study indicate that bridge conditions among the Ts differed substantially. For example, 93.4 percent of the CNJ steel bridges in the sample needed heavy repair, compared with only 7.1 percent of R's steel bridges; the repair percentages for the other Ts' steel bridges fell at various points between those two figures. Gunderson (D) (May 23, 1980) Ex. 76, EL App. G at 303. Similarly, wide disparities exist among the Ts in the repair percentages for masonry bridges. See Gunderson (D) (May 23, 1980) Ex. 76, EL App. G at 302. We must, of course, be careful to refrain from attaching too much importance to these figures for the individual Ts because the samples for each T are not large enough to give a reliable picture of bridge conditions throughout each T's system. Nevertheless, to the extent these figures provide at least some hard evidence of the comparative condition of the Ts' bridges, they undercut Gunderson's position.

The Ts assert that the S&P Study contained numerous other errors including the misinterpretation of Bechtel Study field forms, the failure to make use of other Bechtel Study data such as photographs and field interviews, and the use of inaccurate bridge inventories for some of the Ts. See generally 1 ELF 230-80; 2 RF at 384-434. Although some of the Ts' objections may have merit, particularly the criticism of Gunderson's interpretation of the data on the field forms,[104] we find it unnecessary to resolve these arguments. Because the GPs have not proved that the bridges of all the Ts were in the same state of disrepair, averages reflecting the condition of the bridges of all the Ts lumped together cannot yield reliable results when applied to the bridges

of each T individually. It would be pure happenstance if that sort of statistical technique yielded accurate results.

3. *Yards*

S&P's estimates for the RC of the Ts' yards are open to the same objection as are the bridge estimates: the data from which repair percentages were developed came from a sample that lumped the yards of all the Ts except PC together.[105] Again, this statistical technique rests on the unproved assumption that all the Ts' yards had fallen into the same state of disrepair. Moreover, the sample was not representative of the relative size of the various Ts. Of the 27 yards in the sample, only three were owned by EL, 1 ELF at 209; H. Morgan (D) (Apr. 23, 1980) Ex. 18, EL App. E at 73-75, even though EL was the largest T in the sample, proffering an average of over 2,000 miles of mainline track. See 1980 Study at VIII 5.[106] Finally, the S&P Study did not even approach the sampling frequencies specified by the Bechtel Study, nor was any consideration given to how large a sample had to be to give reliable results. See H. Morgan (D) (Apr. 23, 1980) at 1540, 1584-87, EL App. C at 205, 228-31.

The S&P yard study used other questionable statistical techniques, as illustrated by the following two examples. The study divided yards into three classifications—small, medium, and large. For the small yards, there were inspection results for only nine turnouts. Six of these were located in a single CNJ yard and all were deemed to need replacement. On the basis of those figures, the S&P Study concluded that 67 percent of all turnouts in all of the small yards owned by the Ts except PC needed to be replaced.[107] See H. Morgan (D) (Apr. 23, 1980) Ex. 18, EL App. E at 75; H. Morgan (D) (Apr. 23, 1980) at 1582-84, EL App. C at 226-28. Turnout RC estimates for large yards were not much sounder. Not a single EL or LV turnout was inspected. EL was nevertheless charged with RC (before salvage credit) for turnouts in its large yards ranging from $16.9 million to $26.5

million on its four proffers; LV was charged $7.4 million and $8.7 million on its two proffers. 1 ELF at 213; H. Morgan (D) (Aug. 20, 1980) Ex. 248, EL App. E at 258-64.

4. *The Government Parties' Defense*

In defense of the S&P Study, the GPs point to several studies and sets of statistics, developed by third parties, that purportedly confirm the accuracy of S&P's estimates. They cite the testimony of a PC witness, Clarence Jackman, who performed a RC and MOWE study on the PC lines. His figure for total RC and MOWE on the IFLs over an eleven-and-a-half-year period was about ten percent lower than S&P's figure. The GPs contend that the closeness of Jackman's results to their own confirms S&P's estimates for the other Ts.

EL has a convincing answer: the methodology used to determine PC's needs was not the same as that used for EL and LV. Morgan stated that he used track charts to aid in determining the condition of the Ts' lines. He admitted, however, that track charts were not used in his studies of EL and LV. H. Morgan (D) (Apr. 22, 1980) at 1366-69, EL App. C at 156-59. Similarly, although Morgan used 1976 and 1977 Conrail maintenance information in assessing PC, he had little such information for EL and none for LV. H. Morgan (D) (Apr. 22, 23, 28, 1980) 1369-73, 1465-66, 2063-64, EL App. C at 159-63, 187-88, 427-28. Nor did Morgan have any data regarding interim maintenance work ("section 215 maintenance")[108] done on EL and LV lines pending conveyance of properties to Conrail. He did, however, use such data for PC. H. Morgan (D) (Apr. 22, 1980) at 1369-70, EL App. C at 159-60. Although S&P's line speed and density assumptions were, as stated earlier, demonstrated to be too high in a number of instances relating to EL and LV, its PC data on these items was apparently more accurate, for PC did not challenge Morgan on this issue. ELRB at 56. As to bridges, PC bridges dominated the sample—almost 85 percent of steel bridges

and almost 70 percent of masonry bridges were on the IFLs and the Northeast Corridor lines. See Gunderson (D) (May 23, 1980) Ex. 76, 77, EL App. G at 302-03. It is likely therefore that the sample more nearly reflected the condition of PC's bridges than the condition of the other Ts' bridges. Finally, to assess PC's yard rehabilitation needs, the S&P team used a separate sample made up exclusively of PC yards. H. Morgan (D) (Apr. 16, 1980) Ex. 7, EL App. O at 73-75. In contrast, the sample used for the remaining Ts lumps together yards of all the Ts.

As this list of methodological differences shows, the S&P team used more complete data and more reliable samples in its study of PC than it used for its study of the other Ts at a number of stages. It is not surprising, therefore, that S&P's overall estimate for rehabilitating and maintaining the IFLs is only 10 percent higher than PC's own estimate. Had S&P used the same procedures for the rest of the Ts, there would be some force to the argument that Jackman's PC study validates S&P's methods, and therefore the reliability of S&P's estimates for the remaining Ts. Since S&P's methods were not the same for the rest of the Ts, however, the reliability of the PC estimates only serves to highlight the doubtfulness of S&P's estimates for the remaining Ts.

The GPs also cite statistics for actual rail replacement done by Conrail on the main IFLs between 1976 and 1979 as proof of the reasonableness of Morgan's rail replacement decisions. According to Morgan's testimony, Conrail replaced slightly more rail in those years than Morgan estimated would be required for the same period. H. Morgan (S) (Jan. 30, 1980) at 73-74. Again, because Morgan had considerable data concerning the PC lines that he did not have for the rest of the Ts' lines, his accuracy in predicting rail replacement on the IFLs does not prove the accuracy of his rail replacement estimates for the remaining Ts.

As a final argument in support of Morgan's rail replacement decisions, the GPs point to the results of a study conducted by AA on its Toledo-Ann Arbor line. The AA study estimated that about 18 miles of rail needed replacement, a figure almost the

same as Morgan's. See 1 GPRB at E 13 & n.50. This, the GPs argue, is further proof of the accuracy of Morgan's rail replacement estimates. This segment is so small in relation to the thousands of miles covered in the S&P study, see 1980 Study at VIII 5, and the difference between Morgan's figures and the figures of other independent studies on other lines is so large, that we cannot attach much significance to this single agreement between AA's study and Morgan's study.

Gunderson points to two independently performed studies as proof of the validity of his estimates. The first is a 1977 Conrail Study of the paint condition on its steel bridges. In Gunderson's expert opinion, paint condition is often a good indicator of the overall condition of a bridge. The results of the paint condition study, when reclassified into the repair categories Gunderson used in his own study (heavy repair, light repair, and no repair) were similar. The Conrail Study, like Gunderson's, is s system-wide study encompassing bridges conveyed by all the Ts. It therefore corroborates, if anything, only that Gunderson's system wide percentages are reasonably accurate. As to each T, however, it confirms nothing because neither Gunderson nor the Conrail Study used separate samples for each T.

The second study Gunderson cites for support is one performed by the engineering firm of DeLeuw-Novick concerning bridge RC on Northeast Corridor lines. DeLeuw-Novick's estimate for bridge RC on these lines was slightly larger than Gunderson's. This study confirms only the accuracy of Gunderson's estimates with respect to PC lines, an unsurprising result since his sample is dominated by PC bridges and is therefore likely to yield results representative of the condition of PC's bridges. Gunderson (D) (May 23, 1980) Ex. 76, 77, EL App. G at 302-03. Because there is no proof that the bridges of the other Ts were in the same condition as PC's bridges, DeLeuw-Novick's estimate proves nothing about the accuracy of Gunderson's estimates for the remaining Ts.

5. *Conclusion*

We reject as unreliable the figures generated by the S&P Study. The methods concerning three major items of rehabilitation—track, bridges, and yards—introduced uncorrectable errors into the results. Questionable sampling techniques, in two instances based on the unproved assumption that the rail facilities of all the Ts had fallen into the same state of disrepair, as well as a paucity of data, affect various parts of the Study. The incorrect interpretation of the AREA table and the misclassification of a number of the Ts' lines as to density and speed undermine Morgan's track RC estimates. There are large, inexplicable differences between S&P's results and the results of studies conducted by independent third parties. All these factors direct us to the conclusion that we cannot accept S&P's figures.

B. *Erie Lackawanna's Study*

The EL Study was done by Wyer, Dick & Co., a consulting firm, under the direction of the firm's Chairman and Chief Executive Officer, Charles Shannon.[109] Wyer Dick conducted the study in 1975 with the goal of determining the rehabilitation needed to restore EL's lines to efficient operation at their historical timetable speeds.[110]

Visual inspections of most of EL's track mileage provided the data for the Wyer Dick Study. The inspections were made by EL division engineers who prepared reports of needed rehabilitation work. Shannon (D) (May 25, 1979) Ex. 19, EL App. B at 36-93. Shannon and his team developed unit cost figures for doing the various kinds of work using EL's usual repair practices and production rates and 1975 material and labor costs. The estimate for EL's total system, including both proferred and unproffered lines, was $50 million. See Shannon (D) (May 25, 1979) 714-31, 742-43, EL App. B at 94-108, 148-49; *id.* Exs. 28, 31, EL App. B at 109-47, 155-56.

Shannon then made three adjustments to determine the RC for each of the four acquisitions proffered by EL. First, for each acquisition he excluded the cost of work assigned to lines not included in the acquisition. Second, to give a true picture of the condition of EL in 1973 (two years before his study), he made a deduction to account for the additional deterioration occurring in the intervening two years (the "shortfall" estimate). Finally, Shannon restated all costs in 1973 dollars.

As support for the validity of Shannon's estimate, EL offers the results of a study conducted independently by Chessie at about the same time Shannon did his study. See Preliminary Engineering Plan for Selected Property Acquisitions of Erie Lackawanna, Penn Central, Reading (Chessie Study), Shannon (D) (July 10, 1979) Ex. 36. EL App. B at 199-239. The Chessie Study estimated the cost of rehabilitating the portion of EL's system that Chessie surveyed at about $28.1 million in 1976 dollars. Shannon (D) (July 10, 1979) Ex. 36, EL App. B at 220. Shannon's estimate for essentially the same properties was $36.5 million in 1975 dollars.[111] In conducting their study, Chessie's engineers were aware of, and specifically rejected, significantly higher estimates prepared by DeLeuw, Cather as part of the Bechtel Study. Chessie Study at 14-15 EL App. B at 210-11.

The GPs open their attack on Shannon's estimates by pointing out that they did not include costs for rehabilitating bridges, yards, and signals. Although it is true that Shannon did not include those costs, they are accounted for elsewhere in the study. As to bridges and signals, Shannon determined that what deterioration had occurred would be rectified by the increase in expenditure he projected for routine annual maintenance.[112] Shannon (D) (July 9, 1979) at 983-84, EL App. B at 195-96. As to yards, Shannon concluded that, with the exception of two facilities, no substantial problems existed and that any needed work would be covered by the projected increases in routine maintenance. Shannon did make allowance in his rehabilitation budget for the two EL yards, Marion and Croxton, that he concluded

were in need of rehabilitation. Chessie's RC figures support the conclusion that the yards, signals, and bridges needed no substantial repairs. Chessie allotted only $815,200 for yards, $980,800 for signals, and $3,000,000 for bridges. In view of how low these estimates are, it is plausible that increases in routine maintenance would cure the minor deterioration that had occurred.

The GPs next argue that Shannon's estimates are too low because the study attempted to ascertain only the work necessary to meet minimum standards. They point to a directive issued by EL's chief maintenance of way engineer to the inspectors who gathered the data for Shannon's study. The inspectors were instructed to inspect only those lines not up to the 50 mph operating speed that was stated as the goal for EL's main lines. Shannon (D) (May 14, 1979) Ex. 15, 18 GP Supp. App. at 584. The GPs contend that this proves that the study was concerned not with making a complete evaluation of EL's system, but only with eliminating slow orders.

Shannon agreed in his deposition that a proper rehabilitation study requires a more detailed inspection than the inspection ordered by Chessie's chief maintenance of way engineer. Shannon (D) (May 24, 1979) at 671172, EL App. B at 150-51. He also testified, however, that he specifically countermanded that order. *Id.* Although he apparently did not countermand the instructions in writing, the reports filed by the inspectors show that they viewed most of EL's lines, not just those with slow orders. See EL App. B at 36-93; EL App. N pocket part. Moreover, even for those segments that were not inspected, significant track rehabilitation was ordered based on data obtained from maintenance records and the personal knowledge of EL's engineers. See ELRB at 69-70; EL App. N at 114-15.

The GPs also ask us not to attach any importance to the estimates developed by the Chessie Study, contending it was merely a preliminary report and that Chessie officials undoubtedly contemplated further evaluation of EL's rehabilitation needs. Although the Chessie Study was not as detailed as either EL's or

S&P's study, its methodology was reasonable. Chessie engineers obtained statistical data concerning the installation dates of EL's rail and nonrail facilities along with records of the maintenance performed on them, and confirmed this data by conducting visual inspections of portions of EL's lines. E. Johnson (D) (Mar. 16, 17, 1978) at 4-8, 42-44, EL App. B at 269-73, 32 GP Supp. App. at 306-308. Moreover, Chessie's senior assistant chief engineer in charge of the study testified that he and his team developed these figures with the idea that Chessie's financial planners would rely on the study in determining whether to purchase a portion of EL. E. Johnson (D) (Mar. 16, 1978) at 7-8, EL App. B at 272-73. Since our purpose is to determine how a potential acquirer would view EL's lines, the Chessie Study, on which Chessie was willing to rely in making its acquisition decision, is strong evidence of the reasonableness of EL's estimate.

The GPs argue that if the Chessie Study is used to confirm the EL Study, both Chessie's RC estimate and its annual MOWE estimate must be considered together. They point out that although Chessie's RC estimate is somewhat lower than EL's, the Chessie's annual MOWE figure is significantly higher. The GPs therefore suggest that a true picture of the Chessie Study results can be obtained only by adding together RC and ten years of annual MOWE. As calculated by the GPs, the total of RC and MOWE using Chessie's estimates yields a figure considerably higher than a comparable total using EL's estimates. In fact, the Chessie total falls about midway between the total using EL's estimates and the total using S&P's estimates. See 1 GPRB at E 26. The GPs would therefore have us conclude that the Chessie Study does not confirm EL's study any more than it confirms S&P's study.

As EL points out, the GPs have introduced no evidence that combining RC and MOWE in the manner they propose is a valid technique for comparing the results of Chessie's and EL's studies. In fact, EL's expert, Shannon, testified that such a comparison could not be made. Shannon (D) (July 10, 1979) at 1157-60,

EL App. N at 134-35, 18 GP App. at 358-359. No other witness gave contrary testimony. Shannon did agree with the GPs, however, that RC and annual MOWE are to some extent interchangeable, *id.*, and this proposition is supported by other testimony as well.[113] B. Murphy (D) (June 20, 1980) at 138-39, 2 LV App. at 262-63; see LV at 50. Indeed, both Shannon and Adik, LV's expert, implicitly rely on the notion of interchangeability in excluding certain items of repair—*e.g.*, bridges and signals—from their RC estimates. Their rationale for doing so, which we have accepted, is that they provided for those repairs by increasing their annual MOWE estimates. Shannon (D) (July 9, 1979) at 983-84, EL App. B at 193-94; Adik (S) (EL) (Dec. 31, 1978) at 14. Although RC and annual MOWE are perhaps not interchangeable dollar for dollar, we conclude that there is validity to the GPs' argument and that at least a rough comparison can be made along the lines they suggest.

Even though we agree with the GPs that the comparative technique they suggest is useful, the GPs have failed to convince us that the Chessie Study does not support EL's estimates. EL points out several flaws in the figures the GPs used to compute their 10-year totals.[114] After corrections for these errors are made, the total of combined RC and 10-year MOWE using Chessie's estimates moves considerably closer to the total using EL's estimates. As adjusted, the EL's 10-year total is 85 percent of Chessie's total.[115] In contrast, the S&P's total is 160 percent of Chessie's. The revised pro formas submitted by EL in response to our June 19, 1981 letter demonstrate how inconsequential the difference between Chessie's and EL's estimates actually is. EL substituted Chessie's RC and annual MOWE figures for its own in the financial statement relating to a Chessie acquisition of a combined EL-LV system. The difference in Annual Cash Flow on the Cash Flow Statement averaged less than $1 million per year. *Compare* Memorandum of the Erie Lackawanna Trustees in Response to the Court's Letter of June 19, 1981, (July 10, 1981) at second table following page 10, Sp. Ct. Rep. at N 36177,

with id. at fourth table following page 7, Sp. Ct. Rep. N 36172. We do not thing this difference is substantial enough to erode the corroboration the Chessie Study provides for EL's figures.

The GPs make two final arguments relating to two of the adjustments Shannon made to his raw RC figures. First, they contend that Shannon erred in his calculations concerning the restatement of his estimates from 1975 dollars into 1973 dollars. In deriving costs in his study Shannon used wage rates prevailing on January 1, 1975, and materials prices prevailing on March 31, 1975. To adjust his estimate to 1973 dollars, Shannon relied on indices calculated by the Association of American Railroads (AAR) that provide a basis for comparing year-end wage and materials costs for a given year with the year-end costs from previous years. Shannon used the indices comparing year-end 1975 figures with year-end 1973 figures. The GPs argue that since the wage and materials costs he used in his study were those prevailing at the beginning of 1975 rather than at the end of 1975, it would have been more accurate to compare 1974 year-end figures with 1973 year-end figures; *i.e.*, only a one-year adjustment was needed to restate Shannon's estimates in 1973 dollars.

EL has a ready, if not entirely convincing answer. See ELRB at 67 n.59. As to labor prices, they contend that wage rates generally become effective on January 1 of any given year, and that a two-year adjustment is therefore necessary to get from 1975 labor rates to 1973 labor rates. Similarly, as to materials prices, materials used in 1973 maintenance would have been purchased in early 1973 before work actually got under way, so a two-year adjustment back from March 1975 to March 1973 was also appropriate. We are uncomfortable with EL's explanation concerning the two 1 year adjustment to labor costs, largely because the choice between a one-year and a two-year adjustment hinges on the time of year that labor rates actually increase, and we can find no support for the assertion that labor rates generally go up on January 1.[116] Absent such support, the year-end 1974 index for labor appears more appropriate than the 1975 index.

There is some support for the argument concerning materials, however, because Shannon did testify that the normal maintenance season begins in March; Shannon (D) (May 24, 1979) at 658, 18 GP Supp. App. at 289. Most materials purchases, therefore, would be made in anticipation of the maintenance season. We conclude that as to labor costs only a one-year adjustment is proper, but that as to materials prices the two-year adjustment made by Shannon is correct.

Second, the GPs point to an inconsistency in the calculation of the shortfall adjustment. Shannon made shortfall adjustments to account for the years 1974 and 1975. The GPs note, however, that a legend on a summary sheet identifies the EL figures as an estimate of "catch-up maintenance . . . as of April 1, 1975". If that is correct, the GPs argue, no shortfall adjustment should have been made for 1975 because Shannon's figure did not reflect the effects of any further deterioration occurring in 1975. On the other hand, if Shannon's study actually reflected conditions as of the fall of 1975 when EL's lines were inspected, the shortfall for 1975 was incorrectly computed because it did not account for the effect of § 215 funds provided to EL for maintenance during 1975.[117] There is little doubt that Shannon's study stated conditions as they were in the fall of 1975. Shannon (D) (May 25, 1979) at 714-15, 717, 726-27, EL App. B at 94-95, 97, 106-07. EL does not contest that the shortfall adjustment is incorrect for the reasons stated by the GPs, ELRB at 67 n.59, so we conclude that the shortfall adjustment must be corrected to account for the § 215 funds spent by EL in 1975.

EL's RC estimates stand up under the GPs' attack. The GPs have pinpointed no serious error in Shannon's methodology. The Chessie estimate, prepared by an independent party with no motive to understate costs, corroborates the EL figures. We conclude that EL's figures, as adjusted to correct the two errors identified by the GPs, provide reasonable estimates of the rehabilitation needs of EL's lines.

Appendix H

C. *Lehigh Valley's Study*

LV's RC and MOWE estimates were compiled by Stephen Adik, a LV Vice President with experience in a number of phases of railroad operations including maintenance. Adik-2 (S) (LV) (Dec. 31, 1978) at 2-5. Adik authored two studies of LV, one to estimate the value of all LV lines conveyed to Conrail, another to determine the RC and MOWE of only those lines included in the EL-LV combined systems. He used different techniques to estimate RC in each study. Because we accept the EL-LV acquisition as the most likely outcome in the alternative scenario, we analyze only the study dealing with the LV lines in the EL-LV acquisition.[118]

Adik developed his RC estimate for those lines from information and work papers submitted to the ICC in the 1974 *Ex parte* 305 proceeding. In that proceeding, a number of railroads sought rate increases to provide funds for reducing deferred maintenance and for making capital improvements. To justify the increases the railroads presented their estimates of necessary rehabilitation. LV estimated that $28.1 million was required to rehabilitate its entire system. See LV at 78. Adik adjusted this figure to eliminate the costs attributable to unproffered lines and to restate the estimates in 1973 dollars. He also reduced the *Ex parte* 305 estimates to account for differences between the maintenance work practices of LV and the more efficient work practices of a potential acquirer.[119] Finally, Adik eliminated the costs attributable to bridges, tunnels, and signals because they were small enough to be absorbed in an expanded annual MOWE budget. After these adjustments, RC on LV lines in the EL-LV acquisitions totalled $7.8 million. Adik (S) (EL) (Dec. 31, 1978) at 13-15.

Adik based his annual MOWE estimates on a study conducted by Wyer Dick for USRA, which examined the maintenance costs of railroads similar to LV over a 17-year period. That study

produced unit cost figures for seven major types of track maintenance. USRA adjusted these figures 1973 cost levels and made several other slight modifications. These adjusted figures provided the basis for Adik's estimate for those seven major types of track maintenance, and he extrapolated from that estimate to obtain estimates for other types of maintenance not covered in the Wyer Dick study. Adik's estimate for annual maintenance came to $9.8 million per year. *Id.* at 10-13.

Before examining the GPs' major attack on Adik's study, we address two relatively minor contentions concerning adjustments Adik made to the *Ex parte* 305 submission. The GPs argue, first, that Adik should not have eliminated the costs of nontrack items from his study. Adik's reason for doing so was that the relatively minor deterioration in those items (he placed it at 1.2 years of deferred maintenance at LV's 1973 actual expenditure level, *id.* at 14) could be eliminated over several years by increased annual MOWE. In light of the small amount of deferred maintenance, about $1 million, and the size of Adik's annual MOWE estimate—his estimate is $2.5 million higher than S&P's—we find Adik's explanation reasonable.

The second contention has more merit. The GPs argue that there is no basis for Adik's adjustment to account for more efficient work practices of a potential acquirer. See Adik (S) (EL) (Dec. 31, 1978) Schedule 14 at 1. Adik admitted that he lacked familiarity with the work practices of the Western railroads named as possible acquirers, and that he had only limited knowledge of Norfolk & Western. The only proposed acquirer with which he had any significant familiarity was Chessie. Adik (D) (May 9, 1979) at 72-73, 8 GP Supp. App. at 519-20. The main basis for Adik's adjustment was his observation that USRA equipment and work practices under the § 215 program undertaken in 1975 were more efficient than LV's and that such "equipment and practices, in all likelihood, [were] similar to those already in use by most potential purchasers in 1973-74". Adik (S) (EL) (Dec. 31, 1978) at 14. Adik did, however, testify that

it would be impossible to predict exactly what work practices would apply after an acquisition, because that is a subject negotiated by labor and management. Adik (D) (May 9, 1979) at 76, 8 GP Supp. App. at 521. As we suggest below, however, see pp. 117-18, *infra*, labor would have been flexible in renegotiating inefficient work rules with the acquirers, and profitable railroads are likely to use equipment that approaches as nearly as possible the most efficient equipment available. Consequently, we believe that Adik's adjustment of $2.225 million was appropriate.

The GPs' major attack on Adik's RC estimate revolves around the testimony of Bryan Murphy. Murphy is now a planning engineer for Conrail, but as LV's Chief Engineer in 1974 he was in charge of the study that produced the *Ex parte* 305 submission on which Adik based his estimate. Murphy testified that the *Ex parte* 305 estimate reflected the minimum amount of rehabilitation necessary; that it reflected a "short term 'patchwork' approach to rehabilitation". B. Murphy (S) (Jan. 30, 1980) at 10. As such, he urged, the *Ex parte* 305 submission understates the true rehabilitation needs of LV.[120]

Because of his position as Chief Engineer of LV, Murphy's testimony cannot be taken lightly. Nevertheless, we have reservations about it. The *Ex parte* 305 submission was made in the latter part of 1974. In April of that year, Murphy had produced an estimate for track rehabilitation that placed the cost of rehabilitating track in the entire LV system at $6.5 million. His first *Ex parte* 305 estimate placed track rehabilitation needs at $18.6 million, nearly three times as much as he had estimated only a few months earlier. His estimate for total RC including both track and nontrack items was $24 million. The President of LV, who was well acquainted with the railroad's condition, felt that even this estimate was too low, and asked Murphy to review and resubmit his report. Murphy's final figure, $28.1 million, is the figure Adik relied on in making his estimate. The sequence of events leading to that estimate indicates that Murphy is susceptible to suggestion and casts doubt on Murphy's assertion that the *Ex*

parte 305 estimate was merely a minimum figure. Moreover, LV had no motive to understate that figure; it was trying to justify a rate increase. If anything, LV had a motive to overstate its rehabilitation needs. In short, we are not convinced that the *Ex parte* 305 estimate is as conservative as Murphy says it is.

Fortunately, we need not resolve the issues whether and how much the *Ex parte* 305 submission understates LV's rehabilitation needs, because the overall results of Adik's study do not differ markedly from S&P's results. Although Adik's RC estimate is substantially lower than S&P's, his annual MOWE estimate is substantially higher.[121] Accepting that RC and annual MOWE are to some extent interchangeable and using the rough method of comparison suggested by the GPs in their argument concerning EL, the two studies yield results only seven percent apart. Using S&P's figures, the total of combined RC and ten-year MOWE is $113.36 million; with LV's figures the total is $105.44 million. See H. Morgan Corrections (S) (June 6, 1980) Tables VIII-2aA, VIII-2bA; Adik (S) (EL) (Dec. 31, 1978) Schedules 11, 14 at 1. Given the demonstrated unreliability of the S&P Study, and the tendency of that study to overstate RC, we have no reluctance in accepting Adik's slightly lower figures. Even with Adik's figures, the RC per track mile assessed against LV is substantially higher than the cost assessed against either EL or R.[122]

D. *Ann Arbor*

AA takes an approach different from EL and LV. AA maintains that its Toledo-Ann Arbor line would have needed no rehabilitation at all because its acquirer would have chosen to reduce the operating speed on the segment from 40 mph to 25 mph. To support this contention, AA offered the testimony of two witnesses—Michael Weisman, a financial officer for D,T&I which operated AA before adoption of the FSP, and Warren Hale, a consulting engineer with Thomas K. Dyer, Inc. Weisman stated

that from his vantage point as a cost expert it would not make any sense to maintain the 40-mile stretch in conditions above that necessary to operate at 25 mph. Weisman (D) (June 28, 1979) at 29, 3 AA Supp. App. at 190. Hale corroborated that testimony by stating that because of the small size of the line and the light density of traffic running over it, the Toledo-Ann Arbor segment could be operated at 25 mph with little or no adverse impact on rail operations. Hale (S) (Oct. 15, 1980) at 8.

The GPs attack this evidence as insufficient to prove that an acquirer would have reduced the line's operating speed. They contend that Weisman was not qualified to offer this sort of testimony because there was no showing that he had any expertise in railroad engineering, maintenance, or operations, areas the GPs contend are essential to the making of such a prediction. 3 GP at K 43-44. We disagree. As an expert in the financial aspects of railroad operations, Weisman is well suited to make judgments concerning the impact a reduction in speed would have on profitability; he need not have maintenance experience to determine that a line can operate as profitably at 25 mph as at 40 mph. Moreover, the testimony of Hale provides a corroborating view from a railroad maintenance engineer whose railroading credentials the GPs acknowledge. See 1 GPRB at E 55. Finally, the GPs have offered no evidence to rebut this contention. Although AA's evidence on this point could have been stronger, we deem it sufficient to establish that AA would have been operated at 25 mph.

We cannot, however, accept AA's argument that no rehabilitation would be needed if the operating speed were dropped to 25 mph. AA offered no credible testimony to support that view. AA's witness Hale stated that some rail replacement would still be necessary on AA's line at the reduced speed, although not nearly as much as Morgan predicted. Hale (S) (Oct. 15, 1980) at 8. The single piece of evidence AA cites is a letter from AA's trustee to the FRA listing slow orders on AA. There were but two slow orders calling for speeds below 25 mph in existence in

March 1975, and only one of the two was caused by track deterioration. AA argues that this absence of slow orders proves that no rehabilitation is needed to operate the line at 25 mph. However, the absence of slow orders does not mean that the line is not on the verge of requiring slow orders.

Other evidence submitted by both AA and the GPs suggests that at least some rehabilitation would have been needed even at a lower operating speed. Operating speed has a direct impact on the rehabilitation standards applied to track, but, as the GPs point out, it does not affect those standards relating to bridges, yards, and signals. 3 GPRB at App. A 82-83 & n.171. See generally 1980 Study at IV 18-34. Indeed, Morgan testified for the GPs that reducing the speed would not require a reduction to the original S&P estimate of even 50 percent. H. Morgan (D) (Aug. 19, 1980) at 4574, 28 GP Supp. App. at 346. And as to track rehabilitation, where a reduction in speed would have its greatest impact in reducing rehabilitation, even AA's witness Hale would not go so far as to say that lowering the speed would eliminate all rail replacement. Both Hale and Morgan had originally called for about 18 miles of rail replacement if the operating speed remained at its historical level. See 1 GPRB at E 13. Hale stated that two of these miles would still require replacement at a 25 mph operating speed. Hale (S) (Oct. 15, 1980) at 8-9. And as the GPs point out, the remaining 16 miles not replaced would probably still require some less drastic forms of rehabilitation work.[123]

We conclude that some rehabilitation would be required even if the line's operating speed were dropped to 25 mph. Our problem is to determine how much would have been needed. At the outset, we reject Morgan's statement that, at most, reducing AA's operating speed would have cut his estimate of RC in half. We have already detailed the problems in his initial estimate; adjusting a flawed initial estimate for speed variations would yield only a flawed result. Furthermore, a reading of the transcript of the deposition at which Morgan offered this judgment

reveals that Morgan had no opportunity to consider seriously the effect of a reduction in speed.[124] Indeed, the GPs do not rely on Morgan's remark. See 3 GPRB at A 82.

The only considered evidence on this point is Hale's rebuttal testimony. As noted earlier, Hale stated that the rail on two miles of track would have to be replaced in order to rehabilitate AA to 25 mph operating speed. At his deposition, Hale also stated that no surfacing beyond what would be provided for in normal maintenance would be required. Hale (D) (Feb. 12, 1981) at 130-31, 1 AA Supp. App. at 155-56. The GPs challenge Hale's assessment of AA's track rehabilitation needs because he relied on only two sources in making his judgments—track charts (showing the weight and date of installation of rail) and Sperry Defect Reports (annual reports of rail failures due to rail defects). 3 GPRB App. A 84. The GP's mischaracterize Hale's testimony, however. While these may have been the only written sources he used, Hale also testified that he relied on the knowledge he gained in preparing his original testimony. Hale (D) (Apr. 11, 1979) at 16, 25 GP Supp. App. at 471. Furthermore, the GPs have presented no evidence showing that Hale's reliance on these two sources was improper. Given that Hale was limiting himself to a relatively small length of track of which he had detailed knowledge and that the GPs admit that he is an expert in this area, see 1 GPRB at E 14, we see no reason why his judgment on rail replacement cannot be trusted.

Hale made no attempt in his rebuttal testimony to estimate AA's yard, tie, signal, turnout, or bridge rehabilitation needs assuming a reduced operating speed. The only other evidence on AA's rehabilitation needs is Hale's original study. The GPs correctly identified a problem with relying on this testimony, however. Although most witnesses defined RC as the amount of work necessary to bring the Ts' lines up to good operating condition or the condition "at which the asset should be maintained if operations are to be continue [sic] over an indefinite period of time", Hale (D) (May 16, 1979) at 4, 11 GP Supp. App. at 783;

see note 110, *supra,* Hale's study was designed to determine what expenditures would be necessary to keep AA running for three to five years. Hale (D) (May 16, 1979) at 3-4, 11 GP Supp. App. at 783-84. But while Hale may have understated the AA's rehabilitation needs in this respect, he clearly overstated them in another. Hale testified that, under the federal classification scheme, to operate AA at 45 mph, as he assumed, it would have to be maintained at the level of a 60 mph railroad. Thus Hale was applying much more stringent standards for track rehabilitation than he would have done had he assumed a 40 mph operating speed, as did Morgan and Gunderson. We suspect that Hale's use of excessively stringent standards offset his short-term perspective. Our impression is reinforced when we observe that Hale and Morgan reached strikingly similar results in determining the amount of track replacement necessary.[125] Our reasoning applies equally to all components of rehabilitation affected by operating speed, including mainline ties and turnouts. Since we have no basis for adjusting these numbers to reflect a 25 mph operating speed and since AA has the ultimate burden of proof on this point, we charge AA with the entire cost of these items as estimate by Hale.

Several components of RC, however, are not affected by main line operating speed. For rehabilitation of these facilities—yards, signals, and bridges—we have more difficulty in accepting Hale's estimates because no countervailing error offset the short-term perspective of Hale's study.

On bridges, however, neither can we adopt the GP's estimate. The S&P study concluded that RC for AA's bridges would amount to $480,000. H. Morgan Corrections (S) (June 6, 1980) at Table VII-12aA. But, as AA points out, the S&P sample included only five AA bridges. AA at 162; Gunderson (D) (July 21, 1980) Ex. 146. Of the five AA bridges considered, *none* required anything more than light repair. See AA at 162. Thus, what little evidence the GPs adduced on AA's bridges tends

to support Hale's conclusion that there is no need for rehabilitation work, and that is the conclusion we accept.

With regard to signals and yards, we are confronted with a problem that does not lend itself to a similar resolution. S&P estimated that RC for signals would be $10,000 and that yard rehabilitation would cost of $1,040,000. Hale, on the other hand, does not seem to have offered any figure for rehabilitation of signals, and concluded that yard rehabilitation could be accomplished for $45,000. We know of no way to adjust Hale's figure explicitly to correct for his short-term perspective or to adjust S&P's figure to account for the errors discussed earlier, and we doubt that any potential acquirer would have been able to make such adjustments. A potential acquirer confronted with these figures would have weighed the shortcomings of both estimates and arrived at an educated guess. On yards and signals, then, we find that a potential acquirer would have expected to incur costs of $250,000 in rehabilitation.

The only factor left to be determined is how long the rehabilitation program would have taken to complete. Morgan and Gunderson projected that it would take two years—Hale said only that it would take "several". See Hale (S) (Oct. 15, 1980) at 7-8. Since we do not know how long "several" years is, we accept the GP's evidence on this point.

The following table reflects the rehabilitation costs which we believe an acquirer of AA's lines would have expected to incur:

Item	Amount	Unit Cost	Item Cost
Main line rail	2 miles	$75,000	$150,000
Main line ties[126]	6,288	20	125,760
	400	25	10,000
Turnouts	8	7,500	60,000
Surfacing	NA	NA	0
Bridges	NA	NA	0
Yards and Signals	NA	NA	250,000
Total			$595,760

Appendix H

E. *Annual Maintenance of Way Expenses*

None of the parties devoted a great deal of attention to annual MOWE in their briefs, choosing instead to focus on rehabilitation. Accordingly, most of the Ts can be dealt with briefly. As demonstrated above, LV's MOWE figure is higher than that of S&P and that fact was important in our decision to accept LV's rehabilitation estimate. We do not expect that the GPs will object to our acceptance of LV's MOWE estimate as well. As for AA, the GPs put annual MOWE at $609,000 while AA's witness estimates it at $450,000. H. Morgan Corrections (S) (June 6, 1980) at Table VIII-2bA; Laurie (S) (AA) (Dec. 31, 1978) Ex. 1 at Table 4. Since Laurie was the only witness who based his estimate on the assumption of a 25 mph operating speed, see *id.* at 6, and since the GPs offer no reason why that estimate understates true MOWE, we accept Laurie's figure. This leaves us with EL.

As experts for both EL and the GPs have testified, RC and annual MOWE are to at least some extent interchangeable; one engineer may treat a particular repair item as rehabilitation, another may treat it as MOWE.[127] Any attempt to combine EL's RC estimates with S&P's MOWE estimates therefore incurs the risk of excluding some items of repair and duplicating others. We nevertheless deem it necessary to examine S&P's MOWE estimates to determine whether there is some good reason to substitute them for those of EL. We find none.

To determine MOWE, S&P developed maintenance cycles for each type of rail facility. Each cycle described the amount of annual maintenance needed for a particular facility based on its expected life and maintenance needs. For example, S&P estimated that new 140-pound rail in use on lines with densities of 20-30 MGT needs replacement at a rate of 3.57% per year. 1980 Study at IV 13. How much maintenance each T needed of course depended on the size of its inventories of the various facilities studied. S&P also developed maintenance work functions,

similar to the rehabilitation work functions, to provide unit costs for various kinds of maintenance work. Applying these unit costs to the maintenance needs defined for each T produced annual MOWE estimates.

Comparing EL's MOWE figures with S&P's is difficult because EL did not separately calculate MOWE. Those expenses are accounted for as reductions to net operating income in EL's pro forma statements. According to its own calculations, EL estimates that its MOWE figure for the EL-LV Western Line acquisition is about $9 million lower than S&P's. EL contends that this difference can be explained by a number of errors in S&P's methods that tended to overstate MOWE. At least some of EL's contentions have merit.

EL points first to inaccuracies in S&P's data concerning the amount of track mileage in the EL proffers. The primary error concerns Morgan's overstatement of yard track miles. He used a Conrail system-wide ratio of yard track to main track mileage to estimate the yard track mileage in EL's proffers. Ratios specific to EL were readily available, and EL contends that Morgan should have used them instead of Conrail's system-wide ratios. 1 ELF at 218. The GPs argue that there is no record support for that assertion. 3 GPRB at App. A 194. Common sense, however, indicates that a ratio specific to EL would give a more reliable estimate of EL's yard track mileage than would Conrail's system-wide ratio, which of course covers lines of all Ts. To the extent that the use of the Conrail's ratio overstated EL's yard track mileage, S&P overstated yard maintenance.[128]

El also contends that in developing his MOWE figures, Morgan failed to take into account the effect of his rehabilitation program, resulting in a duplication of rail replacement. For example, Morgan replaced 1,070 miles (40%) of the 2,650 miles in the Western acquisition. See H. Morgan (D) (Aug. 14, 1980) Ex. 185, EL App. E at 238. According to the table in the 1980 Study at IV 13, the replacement rail had a useful life of at least 40 years.[129] Morgan did not exclude or otherwise adjust for this

substantial amount of new rail on EL's lines in estimating annual rail replacement. He projected 56 miles of rail replacement per year, which, over a period of 40 years, amounts to 2,240 miles. See H. Morgan (D) (Aug. 20, 1980) Ex. 247, EL App. E at 256. At that rate of rail replacement, Morgan would replace over 600 miles of rail in EL's lines more than once within a 40-year period.

We do not accept EL's argument that the replacement of more than all of the rail over the 40-year period proves that Morgan's MOWE estimates were excessive. On the contrary, Morgan assumed that the replacement that was part of the rehabilitation program had already occurred when he stated that relaying 2.5 percent of the rail each year would maintain the track in average condition. H. Morgan (D) (May 5, 1980) at 2608-20; EL App. D at 77-89; 3 GPRB at App. A 208-10. Thus, over 40 years beginning from the time rehabilitation was completed, Morgan's maintenance program would replace one hundred percent of the rail, which is exactly the result EL seems to be urging. Yet we do think Morgan's figures are inaccurate to an unquantifiable extent for a reason suggested at his deposition. Although it is reasonable to assume that all the rail would require replacement over a 40-year period, we see no reason to assume that the need for replacement would occur evenly over the 40 years. Indeed, given that 40 percent of the rail would have been newly laid during the rehabilitation years, it is probable that the need for replacement would arise disproportionately in the final years of the 40-year period. The present discounted value of a stream of payments made regularly at constant levels would differ substantially from the present value of a stream of initially small payments followed by larger payments, even though the sum of payments in the two streams was the same. See note 54, *supra*. Morgan testified that he was unfamiliar with discounted value and did not consider it. See H. Morgan (D) (May 6, 1980) at 2879-80, EL App. D at 244-45.

EL also makes several convincing arguments concerning Morgan's overstatement of labor costs in certain maintenance work

functions. Morgan assumed that productivity in yard maintenance work would be very low; only 40 to 60 percent of work time in yards was considered productive. See 1980 Study at V 1-5. This view is contradicted by the Bechtel Manual, which states that full productivity should be assumed in yards except for weather delays. See Morgan (D) (May 7, 1980) Ex. 105, EL App. E at 186. The large difference in figures suggests that Morgan understated yard work productivity. Morgan also overstated labor costs in some work functions by double counting the labor costs attributable to field mechanics, by including the labor costs of signal maintainers in yard maintenance functions even though yards generally do not have signals, by calculating twice as many man hours as necessary for distributing materials for rail replacement, and by overstating the costs of ballast cleaning. 1 ELF at 295-99. Neither Morgan nor the GPs contest these errors.

The GPs effectively rebut most of the other errors asserted by EL. On the whole, S&P's MOWE estimates stand up better than its RC estimates, and that perhaps explains why the Ts' estimates and S&P's estimates are reasonably close to each other. EL has nevertheless convinced us that S&P overstated EL's MOWE costs to some unquantifiable extent. The GPs, on the other hand, have not separately attacked EL's MOWE figures or the methods used to estimate them. In these circumstances, we conclude that, having accepted EL's RC figure, we should accept its MOWE estimates as well.

F. *Conclusion*

The efforts of the Ts, and particularly EL, have exposed a number of errors in the S&P Study sponsored by the GPs. The methods and data employed in several parts of the study were either incorrect or so questionable as to negate any reliability of the estimates it produced. We are convinced that the S&P Study has overstated, to a substantial though unquantifiable degree, the

rehabilitation needs of the Ts. Although S&P's MOWE estimates do not suffer the same shortcomings as its RC estimates, we are also convinced that, at least with respect to EL, S&P's MOWE estimated is too high.

The GPs have similarly exposed errors in the estimates presented by the Ts. Unlike the errors in S&P's study, however, those in the studies relied on by two of the Ts—EL and LV—do not undermine the reliability of the studies as a whole. Furthermore, the errors are all quantifiable and can be corrected by relatively simple recalculations. We therefore decide that the RC and MOWE figures submitted by EL and LV, as corrected to account for the errors detailed in our discussion of those Ts' studies, provide reasonably accurate estimates of the costs that would have faced an acquirer of those lines. As to AA, neither side has provided us with an overall estimate of RC which we can credit. Nonetheless, we believe that the evidence is sufficient to allow us to determine what AA's rehabilitation needs would have been assuming a drop in operating speed. We do fully accept the AA's estimate of MOWE.

IX. Labor Protection Costs

A. *Introduction*

There has been a long history of collective bargaining agreements, federal statutes, and ICC orders that have provided labor protection for railway workers by guaranteeing employment and compensatory financial assistance to workers adversely affected by various types of organizational changes in the railroad industry. An excellent discussion of the history of such labor protection has been provided by Judge Waterman in *New York Dock Ry.* v. *United States*, 609 F.2d 83, 86-90 (2 Cir. 1979), and there is no need to repeat it here.

The GPs argue that the cost of labor protection either would have been borne directly by the Ts—and therefore must be offset against the proceeds of rail use sales—or would have been

assumed by the acquirers—thus reducing sales prices directly. 5 GP at S 1-3. The Ts do not contest this. Rather, they contend that the proffered transactions would have resulted in either minimal or no labor protection costs. ELRB at 254-55; LV at 98. The Ts' responses raise two principal issues—(1) the level of labor protection benefits that would have applied in the proffered transactions; and (2) the costs of this level of benefits—which are addressed in the following sections.

At the outset we note that labor protection costs would have been a factor only in the case of rail use sales and, as later explained, see pp. 116 & n.142, *infra*, even in those only to the extent that the excess of sales price over scrap value would have been greater than the labor protection costs. The GPs do not contend that existing labor protection agreements would have been applicable in the event the Ts abandoned their lines and sold them for scrap, and as our discussion of these agreements below suggests, we would reject such an argument. See pp. 104-10, *infra*. Similarly, the GPs appear to concede that the ICC would not impose labor protection responsibilities on the Ts in the context of complete abandonment of the T's lines for scrap. 5 GP at S 147. In any event, the ICC's decisions under sections 1(18) and 5(2) of the Interstate Commerce Act, 49 U.S.C. §§ 10901, 11701, strongly suggest that no labor protection payments would have been required if a T had abandoned all its lines.[130] Moreover, we would have considerable doubt regarding the constitutionality of ICC imposition of labor protection conditions in the abandonment of a hopelessly losing railroad.[131]

B. *Level of Labor Protection*

1. *Existing Agreements*

Discussion of the level of labor protection that would have accompanied the proffered transactions must begin with an examination of the agreements and statutes bearing on the subject. These would have been of obvious importance in litigation

and would have been an important consideration in negotiations between labor and the Ts. Although the GPs contend that a number of existing labor protection agreements would have been applicable to the proffered transactions,[132] their arguments with respect to the Ts remaining in the case focus almost exclusively on two such agreements—the Washington Job Protection Agreement (WJPA) and the Erie Lackawanna Merger Protection Agreement (ELMPA).

The WJPA, entered into in 1936 by representatives of most rail carriers and railway unions, is binding on all remaining Ts either by succession or adoption, and provides protections for all employees represented by labor organizations party to the agreement. Ex. GPS—Labor 10. The agreement guarantees protected employees a choice between a monthly dismissal allowance of up to 60 percent of a base salary for a maximum of five years following dismissal or a lump-sum separation payment. Both types of benefits vary with the length of an employee's service with the railroad.

The Ts contend that the WJPA would not have been applied in the circumstances of the proffered transactions. 2 ELF at 540-51; LV at 110-14. The WJPA is applicable to employees adversely affected by a "coordination", defined as:

> joint action by two or more carriers whereby they unify, consolidate, merge, or pool in whole or in part their separate railroad facilities or any of the operations or services previously performed by them through such facilities.

WJPA § 2(a). The agreement also provides that:

> the provisions of this agreement are to be restricted to those changes in employment in the Railway Industry solely due to or resulting from . . . coordination[s].

Id.§ 1.

The Ts argue that the proffered transactions would have fallen outside the WJPA's definition of "coordination". They reason that, by completely liquidating its properties and ending its corporate existence, a T would have escaped the WJPA's requirements of "joint action" that "unif[ies], consolidate[s], merge[s], or pool[s]" the properties of two or more carriers. Rather, they argue, the proffered transactions constitute unilateral liquidations, not involving the "joint action" of another carrier. The GPs respond that, insofar as the Ts' lines are to continue in rail use, the proffered transactions are indistinguishable from ordinary mergers, which typically involve the expiration of one party. 2 GPRB at S 110-11 & n.273.

We find the terms "coordination", "joint action", and "unify, consolidate, merge, or pool" ambiguous and unilluminating. The parties have produced little evidence bearing on the meaning of these terms and neither they nor we have found precedent relevant to the question.[183] A literal reading of the language of the WJPA would provide some support for the GP's claim that the agreement would have been applicable in the circumstances of the alternative scenario. We would be reluctant, however, to rest our holding on such a mechanical process of interpretation. The Ts' liquidation present situations unlike the typical merger with which the WJPA is principally concerned. See, *e.g.*, Ables, The History of and Experience Under Railroad Employee Protection Plans 136-37; Ex. GPS—Labor 45. Most notably, ordinary mergers are seldom marked by the characteristics of involuntariness and economic hardship that distinguish liquidations. The important differences between the circumstances of the alternative scenario and those of the subjects ordinarily considered within the scope of the WJPA would make us reluctant to read the ambiguous language of that agreement as applying to the proffered transactions.

However, we need not resolve the question of the proper interpretation of the WJPA. The difficult questions of legal interpretation raised by the WJPA would have confronted both the Ts

and labor's representatives had the proffered transactions actually occurred. Because of the uncertainty—described above —created by these questions, the parties would have harbored little confidence that their interpretation of the agreement would have prevailed in arbitration. We reject the conclusory opinions of the GP's witnesses, *e.g.*, Lowry (S) (Jan. 31, 1979) at 37-39; Mahoney (S) (Jan. 31, 1979) at 43-50, that labor organizations would have insisted on arbitration of disputes regarding the WJPA. These opinions were premised on the notion that the WJPA provided clear support of labor's claims, a contention that we reject.[134] We find that the uncertainty that would have surrounded the question of the agreement's applicability in the context of the proffered transactions would have made both the Ts' and labor's representatives reluctant to seek arbitration of the issue. Neither party would have had any confidence regarding the ultimate outcome of arbitration, and an adverse, binding decision would have seriously weakened the loser's bargaining position. We conclude, therefore, that the parties would have proffered the known hazards of negotiation to the perceived risks of pursuing arbitration to its conclusion. And, as discussed below, we conclude that negotiations would ultimately have produced new labor protection agreements acceptable to all parties.

We reach a similar conclusion with respect to the ELMPA, an agreement entered into by EL prior to its inclusion in the Norfolk & Western system in 1968.[135] The agreement incorporated Norfolk & Western's "Nickel Plate Agreement" and guaranteed both "attrition protection"[136] and the protections of the WJPA to all workers employed by EL as of April 1, 1968. Exs. GPS — Labor 30, 32. The ELMPA provided protection for any covered EL employee "deprived of employment or placed in a worse position with respect to compensation, rules, working conditions, fringe benefits, or rights and privileges pertaining thereto at any time during such employment." ELMPA, at App. A § 1(b), EL App. M at 94.

EL argues that the ELMPA would have been held inapplicable to the proffered transactions by an arbitration panel, 2 ELF at 527-34, reasoning that the ELMPA was impliedly conditioned on EL's continuation as an operating line. The GPs, in response, contend that "the agreement expressly contemplated the contingency that Erie would be unable to provide work for protected employees at some time in the future and required payment of benefits in *all* such circumstances." 2 GPRB at S 106.

It is far from clear to us that the ELMPA would have been applicable in the circumstances of the alternative scenario. The agreement was reached in the context of EL's inclusion in the Norfolk & Western system, and we would not lightly extend its sweeping protections to the quite different circumstances of EL's complete liquidation. Our view seems to be shared by the ICC which discussed the scope of the ELMPA's applicability in *Norfolk & Western Ry. and New York, Chicago & St. Louis R.R.—Merger*, 347 I.C.C. 506 (1974), *aff'd sub nom. Patton* v. *United States*, No. C-74-841 (N.D. Ohio 1975). EL sought suspension of its labor protection obligations during the course of its reorganization proceedings on the theory that the ELMPA was impliedly conditioned on EL remaining under Norfolk & Western's control—which ceased on EL's entering reorganization. Although the ICC rejected EL's contention, we think its reasoning indicated an appreciation of the limits on the ELMPA's applicability. The Commission stated that only when an employee was adversely affected as a result of "facility coordinations or other operational changes" that took place "pursuant to the inclusion of the E-L in the N&W system" was the ELMPA applicable. *Id.* at 513. In the *Norfolk & Western* case, which involved employees adversely affected by transfers and other changes in operating procedures occurring shortly after EL's inclusion in the Norfolk & Western system, this two-pronged test was clearly satisfied. *Id.*

In the circumstances of the alternative scenario there would have been considerable doubt as to whether the ICC's *Norfolk &*

Western standard was met. EL's employees would have been suffering adverse effects nearly a decade after inclusion in the Norfolk & Western system and for reasons unrelated to that inclusion. Moreover, EL's total liquidation and withdrawal from the railroad business bears little resemblance to the small-scale, internal operating changes that the Commission described in *Norfolk & Western.* In short, the terms "facility coordination[ ]" and "operational change[ ]"—particularly when viewed in the context of the *Norfolk & Western* case—cannot readily be applied to the quite different circumstances of the alternative scenario. We conclude that these considerations would have created very substantial doubts as to the applicability of the ELMPA in the proffered transactions.

This uncertainty surrounding the ELMPA would have been heightened by other questions regarding its applicability. EL finds support for its position in the words "during such employment" in the language of the ELMPA quoted above. EL asserts, not implausibly, that "such employment" presupposes its continued existence as an employer, a position that provides textual support for the two-pronged standard articulated by the ICC in *Norfolk & Western.*

Moreover, even if the ELMPA were deemed applicable in the circumstances of the alternative scenario, there would be a very real possibility that the agreement would have been altered by the ICC. In *Norfolk & Western* the Commission stated that it would suspend the requirement of attrition protection upon a "showing of substantial detriment to the public interest." *Id.* at 514. The Commission noted that its prior approval of the ELMPA's attrition protection provisions had been grounded on the fact that these provisions would not "impose a significant burden on any of the carriers involved". *Id.* at 514 n.3. In the circumstances of the alternative scenario, where EL was in a hopeless financial condition and its liability under the ELMPA might have reached $154 million, Kasher (S) (Nov. 1, 1979) at 43, the ICC could

easily have concluded that attrition protection was not only "significant", but so onerous as to require suspension of the agreement. This would have been particularly true if labor's insistence on attrition protection appeared likely to threaten the consummation of the rail use sales.

Although we find EL's arguments that the ELMPA would have been inapplicable to the proffered transactions persuasive, we are convinced that neither EL nor labor would have pursued arbitration to its conclusion. EL would have had little incentive to risk an adverse—and costly—decision from an arbitration panel, even though it likely would have regarded its legal position as relatively secure. Labor also would have been reluctant to seek arbitration, principally because it would have perceived the slight prospects it would have had of prevailing.

2. *Action of the Reorganization Courts*

Our conclusions regarding the uncertainty that would have surrounded the applicability of both the WJPA and the ELMPA are supported by the possibility that, even if these agreements were held applicable to the proffered transactions, they could have been rejected in the Ts' reorganization plans. ELRB at 531-34. The Ts rely on § 77(b)(5) of the old Bankruptcy Act, which provided that a plan of reorganization "may reject contracts of the debtor which are executory in whole or in part". The GPs respond that § 77(n) of the Bankruptcy Act, which provided that "[n]o judge or trustee acting under this title shall change the wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act", would have prevented the rejection of any of the existing labor protection agreements. 5 GP at S 95.

Resolution of the evident conflict between these two provisions of the Bankruptcy Act would have been a difficult task. Although we do not address the question in detail, we do note a claimed disagreement on the issue between a respected authority

and the House Report accompanying the Bankruptcy Code. The Ts refer us to a leading bankruptcy treatise's discussion of a provision of the new Bankruptcy Code, 11 U.S.C. § 1167 (Supp. III 1979), which adopts substantially unchanged the provisions of § 77(n):

> It should be noted that section 1166 [sic] does not preclude rejection of a collective bargaining agreement under section 365 [granting the general power to reject executory contracts] or under a plan. Rejection of a collective bargaining agreement terminates the employer-employee relationship and is not within the proscription of section 1167 which merely prohibits a change in wages or working conditions.

5 Collier on Bankruptcy § 1167.01 (15th ed. 1980).

The GPs contend that the unsupported statement in Collier is inconsistent with the language of § 1167, which provides:

> *Notwithstanding section 365* of this title [providing for the rejection of executory contracts] neither the court nor the trustee may change the wages or working conditions of employees of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act.

11 U.S.C. § 1167 (Supp. III 1979) (emphasis added). Moreover, the House Report accompanying the Bankruptcy Code stated:

> Section 1167 is derived from present section 77(n). It provides that notwithstanding the general section governing the rejection of executory contracts (section 365), neither the court nor the trustee may change the wages or working conditions of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act, except in accordance with section 6 of that

> Act. The subject of railway labor is too delicate and has too long a history for this code to upset established relationships. The balance has been struck over the years. This provision continues that balance unchanged.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 423 (1977).

Even after legislative efforts to clarify the relationship between §§ 77(n) and 77(b)(5), it is apparent that there remains room for considerable disagreement on the subject. Although our conclusion regarding the uncertainty surrounding the interpretation of the ELMPA and the WJPA makes it unnecessary for us to answer the question, the evident confusion as to the proper relationship between §§ 77(n) and 77(b)(5) would have further muddied the parties' conceptions of their legal rights under existing labor protection agreements.

3. *ICC Action*

In addition to the possibility of labor protection obligations arising from existing agreements, the ICC might have imposed labor protection obligations on the Ts as a condition of its approval of the proffered transactions. The GPs contend that the ICC would have considered the Ts' dispositions under § 5(2) of the Interstate Commerce Act, which requires the Commission to impose labor protection conditions as a condition of approval of a transaction. The GPs also argue that, even if the transactions had been processed under § (18), the ICC would have exercised its discretion and imposed labor protection conditions as part of the proffered transactions. 5 GP at S 120-21.

Section 5(2) applies, *inter alia,* to transactions wherein "two or more carriers . . . consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership". Section 1(18) is applicable to "the extension of . . . [a carrier's] line of railroad, or the construction of a new line of railroad or . . . [the acquisition or operation of]

any line of railroad" and to any action whereby a carrier "abandon[s] all or any portion of a line of railroad".

The Ts argue that these statutory provisions are illuminated by a series of ICC decisions involving entire line abandonments in which the Commission permitted the railroads to proceed under § 1(18) rather than § 5(2). *Okmulgee Northern Ry.—Abandonment of Entire Line*, 320 I.C.C. 637 (1964), exemplifies this line of cases. In *Okmulgee*, a railway applied for permission to abandon its entire twelve-mile line, while a second railroad applied simultaneously for permission to acquire and operate portions of the abandoned trackage. The ICC, rejecting an objection by labor representatives, held that the transaction fell outside the scope of § 5(2), and that § (2)(f)'s compulsory labor protection provisions therefore were inapplicable. *Id.* at 645-46. The ICC explained:

> This transaction does not involve a merger or consolidation in the sense contemplated by . . . [§ 5(2)'s] congressional purpose. There is no consolidation of carrier interests, or joining of two or more carriers, with a consequent temporization of competition. There is merely the expiration of one carrier which, because of business adversity, is no longer able to successfully compete; and the willingness of another to move into the vacuum to the extent some need might remain for rail service.

Id. at 639. The ICC also declined to exercise its discretion under § 1(18) to impose labor protection conditions. The Commission stated that, "the imposition of protective conditions in proceedings . . . where a carrier proposes to abandon its entire line of railroad normally is not warranted", *id.* at 645, and observed that "a departure from this principle in particular cases must be supported by clear and convincing evidence", *id.* The Commission relied on similar reasoning in later decisions reaching the same conclusion.[137]

The GPs argue that the Ts' reliance on the *Okmulgee* line of cases is misplaced in that "none of the cases on which the transferors . . . rely involved a significant impact on regional or national rail transportation because each carrier was small and employed relatively few workers." 5 GP at S 147. The apparent thrust of the GPs' distinction is that there is comparatively little need for § 5(2)(f)'s mandatory labor protection provisions where only a few employees are adversely affected. Under these circumstances, dismissed and displaced employees can be absorbed into other rail systems with little difficulty, thereby reducing the risk of both hardship and labor unrest.

Resolution of the question whether § 5(2) or § 1(18) would have been applicable in the alternative scenario presents difficult legal questions. Although we would lean slightly towards accepting the GPs' distinction, we note that in several cases the ICC refused to apply § 5(2)(f) where the track abandonments—and numbers of adversely effected employees—were fairly substantial. *E.g., Tennessee Central Ry.—Abandonment of Operations,* 333 I.C.C. 443, 444-45 (1968) (287 miles of track abandoned; 279 covered employees affected); *Rutland Ry.—Abandonment of Entire Line,* 317 I.C.C. 393, 394, 404 (1962) (332 miles of track abandoned; 489 workers affected). These decisions, however, did not occur, as our case would have, in the context of large-scale regional abandonments and reorganizations. Had all the Ts elected to deny their employees labor protection and seek ICC approval under § 1(18), thousands of railway workers would have been affected. Kasher (S) (Nov. 1, 1979) at 15. This situation would have demanded a response from the Commission entirely different from that required in the *Okmulgee* line of cases cited above. The unusual need for ICC imposition of labor protection that would have arisen in the proffered transactions if the Ts had attempted to avoid making protective payments to their employees might well have resulted in a decision by the Commission to reject the *Okmulgee* cases and require the Ts to proceed under § 5(2). Moreover, the acquiring

lines might well have insisted that the proceeding take place under that section in order to obtain the benefit of the antitrust immunity afforded by § 5(11). Finally, even if the ICC had processed the transactions under § 1(18), we think it might have determined that the standard articulated in *Okmulgee* governing the discretionary imposition of labor protection conditions was satisfied. See p. 112, *supra*.

If faced with the task of attaching labor protection conditions to the proffered transactions, the ICC would likely have adopted a set of benefits similar to those set forth in its decisions in *New Orleans Union Passenger Terminal Case*, 282 I.C.C. 271, 281-82 (1952); *Chicago, Burlington & Quincy R.R. Abandonment*, 257 I.C.C. 700, 704-07 (1944); *Oklahoma Ry. Trustees—Abandonment of Operations*, 257 I.C.C. 177, 197-201 (1944). The Commission relied on these decisions frequently in setting labor protection conditions under §§ 5(2) and 1(18) in the period between 1950 and 1976, and we think it likely that decisions in the alternative scenario would have reflected these precedents. Despite this conclusion, we doubt that the ICC would have had to decide the issue. Instead, we find that, in light of the uncertainties discussed above, negotiations between the parties would have produced an agreement, thus obviating the need for litigation before the ICC regarding the imposition of labor protection conditions.

4. *The Negotiating Process*

We find considerable support in the views of the parties for our conclusion that the level of labor protection benefits would have been decided through negotiations, rather than a new litigation or arbitration. According to EL, "EL and the Government Parties agree that a new agreement would have been reached, albeit with substantially different terms." ELRB at 214. LV does not disagree with this statement, but contends that it would not have entered into a new labor protection agreement which afforded LV

employees benefits higher than those provided by existing agreements. The GPs correctly observe that "virtually every witness who considered the question supports the conclusions that, if the alleged sales had occurred, the transferors, purchasers, and unions would have negotiated new, comprehensive agreements providing labor protection benefits for adversely affected employees". 2 GPRB at S 6 (footnote omitted). *Cf. Norfolk & Western R.R.* v. *Nemitz*, 404 U.S. 37, 42 (1971) (rail consolidations are generally accompanied by new agreements regarding labor protection).[138]

New labor protection agreements would have been attractive to the parties for a number of reasons: the Ts would have avoided the delays and risks of strikes that labor opposition would have involved; the acquirers would have avoided these dangers, and would have been able to resolve questions relating to the integration of the Ts' lines and employees into their systems; and unions could have obtained protections for their members without risking the disastrous loss of jobs that would have accompanied a complete shutdown of the Ts' lines. New agreements would have eliminated the uncertainties surrounding existing legal rights of the parties, and would have facilitated the rail use sales, which offered substantial benefits for all parties involved.

Despite their consensus regarding the likelihood of new labor protection agreements, the parties draw strikingly different pictures of the bargaining process. The GPs, pointing to what they see as an historical trend towards increased labor protection, argue that existing agreements such as the ELMPA and the WJPA would have provided a floor for benefits in the new agreements, 5 GP at S 179, and that labor's efforts to expand upon these existing protections would have been successful. The GPs conclude that the new agreements would have provided the "attrition protection" of the ELMPA for most of EL's employees, and the "Amtrak C-1"[139] protections for all other employees. 2 GPRB at S 75. The Ts respond that the possibility of a shutdown of their lines, and the consequent loss of jobs, would have placed

labor in a precarious bargaining position. 2 ELF at 554. They contend that the inapplicability of the WJPA and the ELMPA would have prevented these agreements from providing a floor for the levels of benefits in the new agreements. Accordingly, the Ts postulate a widespread retreat by labor from historical levels of labor protection.[140]

We find neither description of the labor protection bargaining process persuasive. The historical trend towards increased labor protection is not so one-sided as the GPs suggest, as the concessions by labor in the subsequent liquidations of the Rock Island and Milwaukee railroads indicate.[141] More fundamentally, the bargaining position of labor would have been weaker in the circumstances of the proffered transactions than was historically the case. The unprecedented possibility that—without federal intervention—most railway jobs in the Northeast would have been lost would have substantially restricted labor's bargaining power; the consummation of the proffered transactions would have been as important to the unions as it was to the Ts. Shannon (D) (Jan. 14, 1981) at 67-38, EL App. N at 375-76; Maxwell (S) (EL) (Oct. 15, 1980) at 4-5. As discussed above, the uncertainty surrounding the existing agreements would have made labor disinclined to resort to arbitration. An adverse decision would have been accompanied by a loss of labor's bargaining power, both because of the loss of a negotiating "chip" and the inflexibility of a bargaining position grounded primarily upon the self-destructive threat of strikes.

The Ts' contention that labor would have "panicked" in the proffered transactions, Shannon (D) (Jan. 15, 1981) at 652, 30 GP Supp. App. at 179, is equally overstated. Labor's ability to demand arbitration of the existing labor protection agreements, and the threat of labor unrest and strikes, are inconsistent with the notion of a widespread retreat on labor protection issues. As the parties recognize, strikes would have "virtually foreclosed" rail use sales because of the disastrous effect that even relatively short shutdowns would have had on traffic patterns and earnings

values. 2 GPRB at S 17-18; 1 RF at 35; Shannon (D) (Jan. 13, 1981) at 204-05, 30 GP Supp. App. at 75-76. Although extremely costly to labor as well as to the Ts, labor's ability to deny the Ts the economic benefits of the rail use sales at prices exceeding X by striking would have prevented any wholesale abandonment by labor of historical levels of labor protection.

We conclude that the Ts and labor would have occupied roughly equal bargaining positions. Each possessed the ability to inflict serious costs on the other, yet only by accepting comparable costs themselves. Neither had ironclad cases under existing laws and agreements, yet both could have credibly threatened resort to litigation. All parties would have derived substantial benefits from consummation of the rail use sales. These considerations would have resulted, in all likelihood, in a relatively evenhanded compromise based roughly on historical levels of labor protection.

Before discussing the precise terms of the labor protection agreements that we find the parties would have agreed to, we return to a point noted briefly at the beginning of this Part. The amount of labor protection benefits that unions could obtain would have been limited by the amount by which the proceeds of the rail use sales would have exceeded proceeds from sales for scrap.[142] Since, however, neither labor nor the Ts would know exactly what this excess would be, we do not think the bargaining would have proceeded with this particular figure in mind. Rather the parties would have reached what seemed a reasonable position in the light of the considerations we have discussed, and a T would then have had to decide, on the basis of admittedly imperfect data, whether to sign an agreement embodying that position or to break off the negotiations and abandon or sell at scrap value, which is the most that a buyer unprotected by an agreement would pay.

Although numerous considerations, none of which is easily quantified, would have affected the labor protection negotiations,[143] the bargaining process we have outlined above permits a

very rough prediction of the likely terms of the new labor protection agreements. As we explain below, this bargaining process would have settled on levels of labor protection roughly equivalent to the *New Orleans* conditions that the ICC historically has imposed under § 5(2) of the Interstate Commerce Act.[144] Stated briefly, the *New Orleans* benefits provided for 100 percent of an employee's earnings (for both displaced and dismissed employees) for up to four years following the ICC order approving a transaction plus any residual benefits under the five-year term of the WJPA. Alternatively, there is provision for a lump sum separation payment for dismissed employees at the employee's option. Both dismissal allowances and lump sum separation payments vary in accordance with the length of service of particular employees.

Several considerations support our choice of *New Orleans* benefits as the approximate level of labor protection that the new agreements would have required. As the GPs note, this level of labor protection was imposed by the ICC on numerous occasions between 1950 and 1976, albeit principally in contexts other than complete abandonments.[145] Thus, all parties would have been familiar with the *New Orleans* conditions. This, and the perception of fairness that would have accompanied the choice of ICC-sanctioned levels of protection, would have made the *New Orleans* benefits a palatable compromise for all parties. Moreover, none of the parties would have felt that acceptance of this commonly used set of conditions would set an adverse precedent for future labor protection negotiations. Lastly, benefits based on the *New Orleans* decision would have represented a genuine compromise—providing labor with substantial protections while relieving the Ts of the potential burden of attrition protection.

A similar bargaining process would have governed discussions on other terms of the labor protection agreements. The Ts (and the acquirers) would have been anxious to obtain broad power to transfer employees, both to permit efficient use of labor resources and to minimize labor protection costs. The GPs, relying in part

upon existing agreements limiting EL's right to transfer employees, see agreements cited in 2 GPRB at S 14 n.29, and in part upon limitations contained in labor protection agreements negotiated in other liquidations, see Milwaukee Agreement cited in ELRB at 217 n.225, argue that the Ts would have been unable to obtain unrestricted transfer rights in the new agreements. We find the GPs' reasoning persuasive. Although we do not attempt to reach a precise determination of the issue, we conclude that management would have obtained transfer rights subject to payment of relocation costs and reasonable geographical restrictions.

We also conclude that the new agreements would have contained a compromise regarding protection for non-union employees. Labor would have had considerably less incentive to obtain benefits for this group than for union members. Non-union employees, however, had historically received labor protection benefits as a result of ICC conditioning. See, *e.g., Norfolk & Western Ry. and New York, Chicago & St. Louis R.R.—Merger,* 330 I.C.C. 780, 825 *modified,* 331 I.C.C. 22, *aff'd sub nom. Erie Lackawanna R.R.* v. *United States,* 279 F. Supp. 316 (S.D.N.Y. 1967), *aff'd sub nom. Pennsylvania Central Merger and Norfolk & Western Inclusion Cases,* 389 U.S. 486 (1968) (affirming decision by ICC in which Commission extended labor protection to non-union employees). Nonetheless, protection typically was not extended to supervisory, professional, and executive employees. We conclude that the agreement reached by the parties would have been roughly along the lines of anticipated ICC actions: nonunion operating employees would have been protected and a substantial number of nonunion nonoperating employees would not have been protected.

C. *Calculation of Labor Protection Costs*

As noted at the outset of this Part, the labor protection costs (LPCs) that would have arisen from the new agreements must be deducted from the rail use sales values realizable by the Ts. We think this deduction would have taken the form of a reduction in

the purchase price the acquirers would have paid for the Ts' lines and an assumption by the acquirers of the Ts' labor protection obligations. The Ts would have preferred this arrangement because, by relieving their estates of ongoing LPCs, a speedier distribution of sales proceeds would have been possible. Labor and the acquirers would have desired the arrangement because, by removing the Ts from the picture, it would have simplified their dealings with one another. This reduction would have been arrived at through bargaining between the Ts and the acquirers, which would have been based on the parties' calculations of projected LPCs. Two aspects of this bargaining process make it difficult for us to arrive at an exact estimate of the reduction in purchase prices that would have resulted from an acquirer's assumption of LPCs. First, as noted earlier, note 143, *supra,* any bargaining involves numerous unquantifiable variables. Second, projecting the costs of labor protection is extremely difficult:

> Total employee protection costs can be only rough estimates, since in many cases the actual costs will vary depending upon future events, the state of the economy and decisions made by others.

I FSP at 164. See Ables, *supra,* at 117. Despite these difficulties we think we can arrive at reasonable estimates of the LPC reductions in the purchase prices for the Ts' properties.

The first step in our analysis requires us to determine what an acquirer's management would have projected its LPC liability resulting from the proffered transaction to be. Arriving at an estimate of future LPCs demands consideration of numerous variables—the number of employees adversely affected by the proffered transaction, the average length of service and yearly compensation of a T's employees, the attrition rates applicable to the Ts' workforces, the rate of rehiring of dismissed employees, and so forth. There is little agreement among the parties on these issues or on a methodology for calculating LPCs. In the following sections we attempt to determine what assumptions

regarding these variables the acquirers would have made and what methodology they would have employed in projecting LPCs. We recognize that any one of numerous methods of calculating LPCs could be adopted, but think that the conclusions we reach below approximate the projections that an acquirer would have made. Our task has been made somewhat easier in that, for reasons appearing elsewhere, we need make such projections only for EL, LV and AA.

The second step in our determination of the reduction in acquisition price attributable to LPCs involves consideration of the effect of bargaining between a T and acquirers on these LPC estimates. We address this issue in the section following our discussion of the acquirers' LPC estimates.

1. *Erie Lackawanna*

(a) *Operating Employees*

(i.) *Number of Adversely Affected Employees.* The first step that an acquirer would take in calculating LPCs would be estimating the number of employees who would be adversely affected by the proffered transactions. We discuss the LPCs attributable to EL's operating employees separately from those attributable to nonoperating employees because of the differences in the methodologies chosen by the parties. We first consider the GPs' contentions regarding this issue. The GPs' LPC study was prepared by Richard Kasher.[146] Kasher's study was based on Conrail's Title V Data Base and a Conrail computer model designed, in part, to estimate LPCs. The Data Base contains information relating to subjects such as seniority, age, date of entrance into service, and prior earnings, for every employee of the Ts. Kasher (S) (Nov. 1, 1979) at 16-17. Using the Title V Data Base, Kasher estimated the number of adversely affected employees in each of the Ts' seniority districts, by assuming that the number of such employees would have been directly related to the track and facility abandonments. Kasher (S) (Nov. 1, 1979) at 12-14. Based on these assumptions, Kasher calculated

that 16,626 PC union employees, 3,213 EL union employees, 1,346 R union employees, and 482 LV union employees would have been dismissed in the proffered transactions. *Id.* at 15. Kasher also estimated that 60 percent of the Ts' "non-agreement employees"[147] would have been terminated.[148]

We begin our analysis of the LPCs attributable to EL's operating employees by rejecting Kasher's method of computing the numbers of operating employees that would have been adversely affected by the proffered transactions. Kasher's assumption that there would have been a direct correlation between the track mileage abandoned and the employees terminated is flawed in several respects. Kasher explicitly concedes that this assumption is inaccurate in many instances, and notes that had he had "more time and resources" he would have considered other factors in his analysis. *Id.* at 13-14. The failure to take into account considerations such as general manning requirements for the various acquisitions proffered by EL, proposed rehabilitation and capital improvement programs, and traffic retention data substantially reduces the value of Kasher's estimates of the number of employees adversely affected in the alternative scenario. Maxwell (S) (Oct. 15, 1980) at 6; Grotz (S) (Oct. 15, 1980) at 15-16. Moreover, Kasher's study completely ignores the labor expenses reflected in EL's earnings projections. In order for any degree of consistency to exist between EL's LPCs and its rail use sales values—which are based on the levels of employment reflected in the pro formas—EL's projected operating expenses must serve at least as a starting point for estimating reduction in its workforces.[149]

Even if we were to accept the conceptual basis of Kasher's method of estimating the number of adversely affected EL employees, we would be forced to reject the results of his study because of serious flaws in its execution. First, it was premised on what would have happened to EL in the PC's "refined case",[150] and not on the dispositions proffered by EL. Although the PC refined case was similar to the EL-LV Chessie acquisition, there

were substantial differences between it and the EL-LV Western acquisition, which is the relevant acquisition for our purposes.[151] Second, the personnel supervised by Kasher interpreted his instructions concerning estimating the number of adversely affected EL employees in a variety of inconsistent fashions,[152] and misunderstood important aspects of their assignments.[153] We are unpersuaded by the GPs' attempt to characterize these occurrences as "refinements" that "only enhanced the accuracy" of Kasher's study. 5 GP at S 209 n.44. The ad hoc adjustments to Kasher's methodology were undertaken by individuals with no experience in labor protection studies, and without knowledge of EL's traffic department.[154] We find the combination of conceptual flaws and mistakes in execution that marked Kasher's study to be so serious that, as regards its estimates of the number of adversely affected employees, it cannot provide even a starting point for our attempt to duplicate an acquirer's calculation of EL's LPCs.

EL's estimates of the number of adversely affected employees are derived from Charles Shannon's LPC study.[155] Shannon (S) (Oct. 15, 1980). The methodology of the Shannon study differed in a number of respects from that of the Kasher study. Based on a comparison of lines 1-13 and 19 of the pro formas for the EL Western acquisition with EL's Annual Report to the ICC (R-1 report) for 1973, 32 GP Supp. App. at 537, Shannon calculated the change in operating expenses of the system that the proffered transaction would cause. Shannon (D) (Feb. 11, 1981) at 1063-76, EL App. N at 404-17. Relying on the labor portion of this reduction in EL's operating expenses, Shannon calculated the number of jobs that would be eliminated as a result of the proffered transaction as well as the types and locations of jobs that would be lost. *Id.* Shannon viewed this figure as the number of employees *potentially* adversely affected by the proffered transaction. He reduced the figure by (1) the number of positions in the EL system that would be opened by attrition; and (2) the number of new positions that EL's capital improvement

projects, normalized maintenance programs, and rehabilitation projects would have required. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-22. Shannon concluded that because of these factors, EL's employment needs would have almost completely offset the reduction in jobs reflected in EL's Western acquisition pro formas.

Shannon testified that only two isolated groups of EL operating employees would have been both adversely affected by the proffered transactions and unable to find employment elsewhere on the EL system. In all four proffered transactions 68 marine employees in the New York Harbor would have been terminated. ELRB at 203. In the Chessie acquisitions a number of employees at the Marion Yard would have been dismissed. Aside from these two groups, however, Shannon concluded that no EL operating employees would have been eligible for labor protection benefits.

The GPs claim Shannon's results to be suspect as a Dr. Pangloss approach. It seems almost impossible that EL could have managed so perfectly that attrition and new job opportunities arising from its rehabilitation and capital improvement programs would counterbalance the hundreds of jobs that would be lost as a result of abandonments. Beyond this we have some more detailed misgivings regarding certain aspects of Shannon's study. Shannon performed actual calculations of the number of adversely affected employees only for the EL Western acquisition. Although these figures can provide a foundation for our discussion, which principally concerns the EL-LV Western acquisition, we must adjust these conclusions to reflect the abandonment of EL's Scranton line in the EL-LV combination. Moreover, we note that Shannon's "study", as it appears in Exhibit 16 to Shannon's disposition, was submitted long after he had prepared his statement announcing his conclusions regarding EL's LPCs. Shannon (D) (Feb. 11, 1981) at 1188-94, 30 GP Supp. App. at 273A-273G.

Despite these reservations we believe Shannon's LPC study provides a sufficient basis for calculation of EL's LPCs. As discussed above, Shannon's calculations posited a substantial reduction in the number of EL operating *positions*. Based on Shannon's workpapers, we calculate that Shannon concluded that 1,819 EL operating jobs would have been eliminated in the five years following the EL Western acquisition. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-23.[156] We accept the figures contained in Exhibit 16 as reasonable estimates of the number of operating positions that would have been eliminated as a result of the proffered transactions. Although Shannon did not specifically consider the effects on employment of each of the operating changes reflected in the EL pro formas, sheets 1-16 of Exhibit 16 indicate that Shannon did consider the major dislocations that the proffered transactions caused—the Marion and Croxton Yard projects, the abandonment of 700 miles of trackage, and the acquisitions of labor-saving equipment. Although we have some reservations regarding the apparent exclusion of the smaller operating changes from Shannon's study, we are willing to discount the effect of these changes. EL's witnesses testified that small, isolated employment reductions could be managed so as to minimize LPCs through the use of attrition and by bargaining with unions. Shannon (S) (Oct. 15, 1980) at 11-12. See also Maxwell (S) (Oct.15, 1980) at 8-11. Since there is no particularized rebuttal by the GPs of Shannon's conclusions regarding the number of jobs that would have been lost in the proffered transactions, we find these estimates sufficiently accurate to serve as a base for our calculations.

(ii.) *Attrition and Rehire Rates.* We take a different view, however, of Shannon's application of attrition rates and rehire rates to these figures. Despite his view that more than 1,800 operating *positions* would be eliminated in the proffered transactions, Shannon concluded that virtually no operating *employees* would have been adversely affected. As noted above, Shannon's

determination was based principally on his use of attrition and rehire rates.

Relying on EL's historical experience, Shannon calculated and applied an individual attrition rate for each of the six "ICC Groups"[187] that he determined would be effected by the proffered transactions. These rates ranged from 5.5 percent for dispatchers to 20.5 percent for watchmen. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-23.

Exhibit 16 reflects two different treatments of the rehire rate issue. For ICC Group II, Shannon assumed—without explanation—a rehire rate of 50 percent. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheet 1, line 16, EL App. N at 517. For all other EL operating employees (ICC Groups III, IV, V, VIa, and VIb) Shannon apparently assumed a 100 percent rehire rate. Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 2-6 , EL App. N at 518-23.

We base our calculations on a methodology somewhat different from that used by Shannon. Rather than applying the relevant individual attrition rates to particular ICC Groups, we apply a systemwide average attrition rate to EL's entire pool of operating employees. We adopt this approach principally to facilitate our computation of EL's labor protection costs. Our methodology, however, does EL no injustice: the attrition rate we use (10.4 percent) is simply the weighted average of the attrition rates applied by Shannon. Indeed, by applying attrition and rehire rates on a systemwide basis, rather than treating ICC Groups individually, we increase the extent to which job openings in one ICC Group can be filled by dismissed employees from other ICC Groups. Similarly, the GPs have no cause for complaint. Kasher used a systemwide attrition rate (10.8 percent) that was higher than that we apply here. Kasher (S) (Nov. 1, 1979) at 23-26.

Although we thus accept the attrition rate applied by Shannon, we reject his assumptions regarding rehire rates. The record contains a startling variety of rehire rates: Shannon used both 100

percent and 50 percent; Kasher used 50 percent, which he felt was extremely conservative; PC, in a 1966 study, estimated 33 percent and Grotz used both 100 percent and 20 percent.[158] We are impressed by the arguments advanced in support of the lower rehire rates. As Kasher commented, "Rail employees are not fungible", Kasher (S) (Nov. 1, 1979) at 26. In order to obtain personnel with the requisite skills for a particular position, those managing EL's system frequently would have had to look beyond the pool of surplussed EL employees. In addition, management's ability to rehire surplussed employees would have been limited by timing difficulties; many positions would have had to be filled quickly to maintain operating efficiency. Moreover, as discussed above, labor would have demanded reasonable restrictions on an acquirer's transfer rights, and the new labor protection agreements would have contained features such as geographical restrictions on transfer rights, as well as provisions regarding seniority, craft, and class limitations that would have restricted management's ability to fill job openings with surplussed employees, see pp. 117-118, *supra*. Kasher (S) (Nov. 1, 1979) at 26-27; Grotz (S) (Oct. 15, 1980) at 24-25. Lastly, the acquirers would have been inclined to take a relatively conservative view of the rehire rate, particularly in the context of negotiations with the Ts. Although we can do no more than provide a rough estimate, these considerations suggest to us an overall rehire rate for EL operating employees in the range of 33 percent. We apply this rate both to positions opened by attrition and to positions created by rehabilitation and capital improvement programs in order to determine the extent to which these positions could have been used to reduce the number of EL employees dismissed.

As noted above, we accept Shannon's raw data regarding the number of jobs that would have been lost in each of the years following the proffered transactions. These figures, according to our calculations,[159] are as follows:

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Table 1

Number of Positions Eliminated Following Acquisition

Year 1	318
Year 2	543
Year 3	539
Year 4	418
Year 5	1
Total	1,819

These figures, reflecting reductions in the number of operating *positions*, must be adjusted to reflect the number of *employees* who either would have been rehired shortly after dismissal or would not have been terminated because of the creation of new jobs or vacancies in existing positions due to attrition. First, we apply the 10.4 percent attrition rate to the total number of EL operating employees in each of the years following the proffered transaction. Our computations indicate that the following number of operating positions would have been vacated each year due to attrition:[160]

Table 2

Attrition-Created Positions

Year 1	961
Year 2	992
Year 3	970
Year 4	921
Year 5	884

Based on Shannon's data, see Shannon (D) (Feb. 11, 1981), Ex. 16, at sheets 1-6 EL App. N at 517-23, which relied on EL's pro formas, we calculate that the following number of new positions would have been available each year as a result of EL's rehabilitation and capital improvement programs:[161]

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Table 3

New Positions Available Following Acquisition

Year 1	616
Year 2	334
Year 3	67
Year 4	68
Year 5	69

Adding the two sets of figures in Tables 2 and 3 produces the following figures for the total number of annual employment openings in the EL system in the years following acquisition:

Table 4

Vacant Positions Following Acquisition

Year 1	1577
Year 2	1326
Year 3	1037
Year 4	989
Year 5	953

Application of the 33 percent rehire rate arrived at above to these totals produces the following figures for the number of operating positions opened by attrition or newly created that an acquirer's management would have been willing to consider available to reduce the number of EL operating employees that would be surplussed:

Table 5

Rehires and Nondismissals

Year 1	1577 x 33%	=	520
Year 2	1326 x 33%	=	438
Year 3	1037 x 33%	=	342
Year 4	989 x 33%	=	326
Year 5	953 x 33%	=	315

Subtraction of these figures from the numbers of EL operating positions eliminated each year (Table 1) produces the number of EL operating employees who would have been eligible for labor

protection benefits each year following the proffered transactions:[162]

Table 6

Employees Dismissed Following Acquisition

Year 1	(202)*
Year 2	105
Year 3	197
Year 4	92
Year 5	(314)*

* Numbers in parentheses indicate need for new hires in excess of surplussed employees pool.

(iii.) *Lump Sum Separation Payments.* Under the *New Orleans* benefits formulas surplussed employees are offered a choice between a monthly dismissal allowance and a lump sum separation payment, see p. 117, *supra.* Calculation of EL's LPCs requires an estimate of the number of employees who would have chosen each of these types of benefits. Both Shannon and Grotz assumed 50 percent of EL's operating employees would have chosen lump sum payments. Their conclusions were based on the view that EL's employees would have been confident that they could find other employment and that, therefore, a lump sum payment would be preferable to a dismissal allowance that, in theory, would be reduced by outside earnings. Shannon (S) (Oct. 15, 1980) at 17-18; Grotz (S) (Oct. 15, 1980) at 27-28 & n.17. Kasher, in contrast, assumed that only 25 percent of EL's employees would have chosen a lump sum payment, because of the importance to EL employees of fringe benefits and the possibility of reemployment on the EL system with continued seniority rights that would have been lost by the choice of the dismissal allowance option.

On the whole we find the Ts' 50 percent figure closer too the mark than the GPs' estimate.[163] Seniority rights would have been of comparatively little importance to less senior EL employees who, because dismissals would have been in reverse order of

seniority, would have constituted the majority of surplussed employees. We feel compelled, however, to reduce the Ts' figure to 40 percent to reflect the reluctance of EL's employees to re-enter the job market without the protection of a monthly dismissal allowance. Kasher (S)(Nov. 1, 1979) at 17-18.

Application of this figure to the total number of EL operating employees who would have been eligible for labor protection benefits in each of the years following the proffered transaction (Table 6) produces the following figures:

Table 7

Dismissed Employees Electing Lump Sum Payments

Year 1	0
Year 2	42
Year 3	79
Year 4	37

Calculation of the costs that would have resulted from lump sum payments to these employees requires consideration of several factors. First, we must estimate the average base period salary of the employees choosing lump sum payments. We arrive at this figure by first calculating a weighted average of the average yearly compensation rates of various groups of EL employees in 1973. According to our calculations, the average 1973 salary of EL operating employees was approximately $11,800. We adjust this figure to obtain figures for 1975—the year preceding the date when we believe the proffered transaction would have occurred—by applying "growth factors" prepared by a PC witness, Richard Olsen, and relied upon in the Grotz LPC study. Grotz (S)(Oct. 15, 1980) at 25 Table 6 n.5, citing Olsen (S)(Cost and Revenue) (Dec. 1, 1978) at 17 & Table B-8. These factors reflect the real increase of railway wages during the relevant period. Based on these figures we calculate that the average yearly compensation (in 1973 dollars) for EL employees in these years would have been:

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Table 8
Real Railway Wage Projections

1973	$11,800
1974	$11,800 x 1.024 = $12,083
1975	$11,800 x 1.024^2 = $12,373
1976	$11,800 x 1.024^3 = $12,670
1977	$11,800 x 1.024^4 = $12,974
1978	$11,800 x 1.024^5 = $13,286
1979	$11,800 x 1.024^6 = $13,605

Next, we adopt crude adjustments to these figures to reflect the fact that most of the employees who would have been dismissed would have had less seniority, and therefore lower average annual compensation rates, than the average EL operating employee. In addition, we adjust these figures to reflect the fact that, because the proffered transactions would have taken place on April 1, 1976, the average base period compensation would have comprised eight months of 1975 wages and four months of 1976 wages:

Table 9

Dismissed Employee Average Wage

1975	$12,373 x 95% = $11,754
1976	$12,670 x 95% = $12,037
1977	$12,974 x 95% = $12,325
1978	$13,286 x 95% = $12,622
1979	$13,604 x 95% = $12,924

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Base Period Salaries

Employees Dismissed in Period Starting:

4/76	$11,754 x 67% =	$ 7,875
	$12,037 x 33% =	$ 3,972
		$11,847
4/77	$12,037 x 67% =	$ 8,065
	$12,325 x 33% =	$ 4,067
		$12,132
4/78	$12,325 x 67% =	$ 8,258
	$12,622 x 33% =	$ 4,165
		$12,423
4/79	$12,622 x 67% =	$ 8,457
	$12,924 x 33% =	$ 4,265
		$12,722

The *New Orleans* benefits provided for varying levels of lump sum separation payments depending upon the length of an employee's service with a carrier. The applicable figures are as follows:

Table 10

Length of Service	*Benefit Level*
1-2 years	3 months pay
2-3 years	6 months pay
3-5 years	9 months pay
5+ years	12 months pay

See WJPA, Ex. GPS - Labor - 10 at 176.

Accordingly, we must estimate the number of employees choosing lump sum payments who would have fallen into each of these categories. The record contains very little evidence on this

issue. Grotz adopts certain assumptions regarding the LV workforce, which may be taken to be roughly applicable to EL. Grotz's figures place the vast majority of employees choosing lump sum payments in the 5+ years of service category, a result we accept principally because the acquirers would have been inclined to insist on a conservative projection. Grotz (S) (Oct. 15, 1980) at Table 4, 5.[164] Application of these figures to the *New Orleans* benefit formulas and to the average base period compensation rates set out above produces the following cost of lump sum payments in the EL Western acquisition:

Table 11

*Lump Sum Payments**

Year 1	0	
Year 2	1 x .25 x $12,132	= $ 3,033
	2 x .5 x $12,132	= $ 12,132
	3 x .75 x $12,132	= $ 27,297
	36 x 1 x $12,132	= $436,752
Total		$479,214
Year 3	1 x .25 x $12,423	= $ 3,106
	4 x .5 x $12,423	= $ 24,846
	6 x .75 x $12,423	= $ 55,904
	68 x 1 x $12,423	= $844,764
Total		$928,620
Year 4	1 x .25 x $12,722	= $ 3,181
	2 x .5 x $12,722	= $ 12,722
	2 x .75 x $12,722	= $ 19,083
	32 x 1 x $12,722	= $407,104
Total		$442,090
Grand Total		$1,849,924

* Source for number of employees receiving payments: Table 7.

(iv.) *Dismissal Allowances.* The next step in our calculation of EL's LPCs requires computation of the cost of dismissal payments made to surplussed EL operating employees. As suggested above (Tables 6 & 7), the following numbers of EL operating employees would have chosen to receive dismissal allowances in the years following the proffered disposition:

Table 12

Dismissed Employees Electing Dismissal Allowances

Year 2	63
Year 3	118
Year 4	55

We must adjust these figures to reflect the effect of rehiring surplussed employees into positions opened by attrition or created by EL's rehabilitation and capital improvement programs (Table 5):

Table 13

Employees Receiving Monthly Dismissal Allowances

	Year	*1*	*2**	*3**	*4**	*5***	*6*
Employees	1	0	0	0	0	0	0
Dismissed	2	-	63	63	63	0	0
in Year:	3	-	-	118	118	0	0
	4	-	-	-	55	0	0

* Rehire rates were taken into account in determining the number of employees assumed surplussed each year. See p. 128-29, *supra.* Consequently, we make no allowance for rehires here, to avoid double-counting with Tables 5 & 6. We assume, as we think an acquirer would have, that the excess available positions in year 1, see Table 6, would not be available for surplussed employees in later years, because of timing difficulties and efficiency requirements.

** 314 rehires, as reflected in Table 6. All rehires assumed to come from earliest group possible. Thus, 314−63−118−55=78, is greater than 0, as reflected in year 5.

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The *New Orleans* benefits provide for dismissal allowances of 100 percent of an employee's base period compensation, calculated at pp. 131-32, *supra*, minus any outside earnings or unemployment compensation received by an employee. The record contains two different conclusions with respect to this latter issue. Kasher, on the assumption that employees receiving dismissal allowances would not report their outside earnings, did not make any adjustment in the cost of dismissal allowances to reflect outside earnings. Kasher (S) (Nov. 1, 1979) at 21. Grotz adopted a figure based upon an assumption that each employee dismissed would find employment three months following dismissal at a salary equivalent to 50 percent of pre-dismissal earnings increased to reflect general wage escalations. Grotz justified this assumption on the grounds that employees would not have "flouted the express direction of the ICC" and on the fact that an acquirer would have established a "prudent procedure" for ensuring that outside earnings were reported. Grotz (S) (Oct 15, 1980) at 28-29 & Table 9. We see no reason why an acquirer would not have considered itself able to achieve at least partial success in policing the reporting requirements of the new agreement. Based roughly on Grotz's calculations (with a crude downward adjustment to reflect enforcement costs and other difficulties), we adopt a 50 percent offset to monthly dismissal allowances to account for outside earnings.

Using the figures set out above regarding the average base period compensation of the employees choosing dismissal allowances (Table 9) and the figures relating to the numbers of EL operating employees receiving dismissal allowances (Table 13), we arrive at the following conclusions regarding the cost of monthly dismissal payments:

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Table 14

Costs of Monthly Dismissal Allowances

Year 1		0
Year 2	63 x $12,132 =	$ 764,316
Year 3	63 x $12,132 =	$ 764,316
	118 x $12,423 =	$1,465,914
Year 3 Total		$2,230,230
Year 4	63 x $12,132 =	$ 764,316
	118 x $12,423 =	$1,465,914
	55 x $12,722 =	$ 699, 710
Year 4 Total		$2,929,940
Year 5		0
Grand Total		$5,924,486
		x 50%
Total Cost of Monthly Dismissal Payments		$2,962,243

(v.) *Fringe Benefits.* The *New Orleans* benefits also guaranteed employees electing to receive monthly dismissal allowances fringe benefits, such as health and welfare benefits. Both Grotz and Kasher estimated that this item would result in LPCs equal to approximately 17 percent of the cost of dismissal payments, before reduction for outside earnings. Kasher (S) (Nov. 15, 1979) at 22-23; Grotz (S) (Oct. 15, 1980) at 29. Shannon apparently adopted a similar figure in the context of operating employees. We find Grotz's and Kasher's estimates—which are based on historical data compiled by the Railroad Retirement Board—reasonable and accept them for purposes of our computations. An acquirer likely would have calculated that total costs incurred as a result of fringe benefit payments to EL operating employees would have been:

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Table 15

Cost of Fringe Benefits

17% x $5,924,486 = $1,007,163

(vi.) *Relocation Costs.* There is general agreement among the various LPC studies regarding the cost of relocating an individual employee. Both Shannon and Kasher estimated relocation expenses of $4500 per relocated employee. 2 ELRB at 217 & n.226; Kasher (S) (Nov. 1, 1979) at 28. Grotz estimated that it would require $600,000 in moving expenses to relocate 120 LV employees, an average cost of $5000 per employee. Grotz (S) (Oct. 15, 1980) at 32. USRA, in the FSP, estimated $5000 in moving costs per relocated employee. 1 FSP at 165. We adopt the $5000 figure, because the Ts would have been required to pay both moving and other relocation expenses, thus requiring slight upward adjustments of the parties' figures.

There is very little evidence in the record concerning the number of EL employees who would have been eligible for reimbursement of relocation expenses. Shannon provides rough estimates for operating employees at the Marion shop and the marine workers at the New York Harbor, but does not address the issue as it relates to the EL system generally. Kasher, on the basis of his experience at Conrail, estimated that approximately 50 percent of all rehired employees would receive relocation benefits. Kasher (S) (Nov. 1, 1979) at 27. Although we are reluctant to apply this figure without some indication of the relevance of Kasher's Conrail experience to EL's case, the dearth of evidence on the subject in the record leaves us little choice. As reflected in Tables 1, 5, and 13 the following numbers of employees would have been rehired (or transfered prior to termination) in the years following the proffered transactions:

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Table 16

Rehired Employees

Year 1	318
Year 2	438
Year 3	342
Year 4	326
Year 5	236
Total	1,660

Application of the 50 percent rate (representing rehired employees eligible for relocation benefits) and the $5000 average cost per employee produces the following total cost of relocation expenses:

Table 17

Relocation Costs

1,660 × 50% × $5000 = $4,150,000

(vii.) *Displacement Costs.* The *New Orleans* conditions provide for payment of displacement expenses to employees who accept employment at salaries less than their base period compensation. As Kasher conceded, displacement allowances would have decreased rapidly in the years following the proffered transactions, principally because the earnings gap between base period compensation and yearly salaries would be eroded by general wage increases. Kasher (S) (Nov. 1, 1979) at 30. Kasher estimated that 12 percent of the surplussed employees rehired in the first year following acquisition would receive displacement allowances. His statement does not reveal his assumptions regarding later years, although in light of his general views that displacement allowances would have been concentrated in the period immediately following the proffered transactions, we feel safe in assuming that after year 1 this item may be disregarded as *de minimis*. Shannon apparently did not address this question in

the context of EL's operating employees. We adopt Kasher's 12 percent figure as a reasonable estimate of the number of employees that would receive displacement allowances.

We reject, however, Kasher's estimate of the average monthly displacement payment that EL operating employees would receive. Kasher used a figure ($2,717.04 per year) derived from the "average monthly displacement allowance *claim*" submitted to Conrail in 1978. As the Grotz study points out, Grotz (S) (Oct. 15, 1980) at 30, this figure is far larger than the average amount of displacement payments actually made by PC in 1973 and 1974: $76.28 per year. See I FSP at 165. Moreover, the Conrail figures relate to claims made under § 505(b) of the Rail Act, which—unlike the *New Orleans* benefits—adjusted an employee's base period compensation to reflect subsequent general wage increases. We find the figures relating to actual payments made by PC far more relevant to our inquiry than the claims submitted to Conrail, and accept the $76.28 figure. Indeed, because the PC payments were made primarily pursuant to agreements that adjusted base period salaries to reflect general wage increases, this figure is probably somewhat overstated. We accept it, however, on the theory that the acquirers would have made a conservative estimate of their potential LPC liability. Based on the total numbers of operating employees in EL's workforce following acquisition (Table 2 & note 160, *supra*), we calculate that LPCs attributable to displacement allowances would have totalled:

Table 18

Displacement Costs

9232 x 12% = 1108 displaced employees
1108 x $76.28 per claim = $84,518

(viii.) *LPCs Attributable to Abandonment of EL's Scranton Line.* As noted previously, Shannon's study addressed only the EL Western acquisition. Shannon testified, however, that the

EL-LV Western acquisition would involve identical LPCs. Although the EL-LV Western acquisition contemplated abandonment of the Scranton line, which would continue to rail use in the EL Western acquisition, Shannon concluded that all employees on this line would find employment on the nearby, parallel LV line. Shannon (D) (Jan. 15, 1981) at 724-26, EL App. N at 395-97. Positions on that line would have been available, according to Shannon, because of increased normalized maintenance and new rehabilitation expenses. Shannon (S) (Oct. 15, 1980) at 64; Adik (S) (Dec. 31, 1978) at 13-15. Although the GPs reject this contention, 2 GPRB at S-21, 26-27, they offer no particularized criticism of Shannon's assumption. Absent criticism, we accept Shannon's estimate, although we think it likely that an acquirer would have determined that some relocation expenses would have been involved, particularly in the MOW department. Based on our rough calculation of the number of employees who would have been effected and the average cost of relocating an employee, we estimate that the acquirers would have projected a cost of approximately $450,000 for this item.

(ix.) *Marine Employees.* Shannon determined, ELRB at 203, that in all four proffered transactions 68 marine employees working in the New York Harbor would have been terminated—a conclusion we accept. Shannon assumed that all marine employees would have chosen a lump sum payment rather than a monthly dismissal allowance, principally because of the existing employment opportunities with other operators in the New York Harbor area. Shannon (D) (Jan. 14, 1981) at 372-75, EL App. N at 352-53. We see no basis for questioning this conclusion, which was based on Shannon's personal knowledge of and experience in the New York Harbor. Shannon (D) (Feb. 11, 1981) at 1136-37, EL App. N at 456-57.

Shannon applied at 12 percent attrition rate to the 68 marine employees for the one year period preceding the acquisition, and concluded that only 60 employees would be employed in the harbor at the date of the acquisition. We adjust this figure

somewhat to reflect our finding that the 12 percent attrition rate is too high, adopting instead a 6 percent rate. Shannon conceded that such a rate would have been appropriate, and we think that an acquirer's management would have opted for the more conservative number. Shannon (D) (Jan. 14, 1981) at 366; EL App. N at 350. Accordingly, we conclude that 64 marine employees would have received lump sum severance payments. The average yearly wage in 1973 for these employees was $11,580. *Id.* Adjusting this figure to reflect the increase in real railway wages, we obtain an average 1975 base period compensation of approximately $12,145. See Table 8. Assuming, as we did in the context of operating employees in general, see pp. 132-33, *supra,* that LV's average length of service distribution would apply, and using the WJPA formula (Table 10), we conclude that the total lump sum payments that EL's marine employees would have received would have been:

Table 19

Marine Employees

1 x .25 x $12,145 =	$ 3,036
3 x .5 x $12,145 =	$ 18,218
5 x .75 x $12,145 =	$ 45,544
55 x 1.0 x $12,145 =	$667,975
Total	$734,773

(x.) *Total LPCs Attributable to EL Operating Employees.* Addition of the LPCs attributable to lump sum payments (Table 11), dismissal allowances (Table 14), fringe benefits (Table 15), relocation expenses (Table 17), displacement allowances (Table 18), EL's marine employees (Table 19), and abandonment of EL's Scranton line provides the following estimate of LPCs attributable to EL operating employees:

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Table 20

Total LPCs Attributable to EL Operating Employees

Lump Sum	$ 1,849,924
Dismissal	$ 2,962,243
Fringe Benefits	$ 1,007,163
Relocation	$ 4,150,000
Displacement	$ 84,518
Marine Employees	$ 734,773
Scranton Line	$ 450,000
Total	$11,238,621

(b) *Nonoperating Employees*

We base our calculations of the LPCs attributable to EL's nonoperating employees on the Shannon study, principally because the GPs' study did not specifically address this precise issue. Applying the methodology discussed above in the context of EL's operating employees, Shannon concluded that approximately 213 EL union nonoperating employees would have been terminated, 125 would have been relocated, and 310 EL nonunion nonoperating employees would have been terminated. Shannon (S) (Oct. 15, 1980) at 4 & 22. Based on an assumed level of benefits for union employees roughly equivalent to the *New Orleans* benefits, Shannon estimated that the LPCs resulting from these terminations would total $4.1 million. As in the case of operating employees, we must adjust Shannon's conclusions to reflect our disagreement with his assumed attrition and rehire rates.

Based on Shannon's workpapers, 999020-999043, EL App. N at 628-39, and testimony, Shannon (S) (Oct. 15, 1980) at 21-22, we estimate that the following numbers of EL nonoperating positions would have been eliminated in the years following acquisition:[165]

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Table 21

Positions Eliminated Following Acquisition

	MOW	*MOE*	*Trans.*	*Traff.*	*Gen.*	*Total*
Year 1	19	14	31	136	227	427
Year 2	19	14	31	136	228	428
Year 3	19	19	15	0	0	53
Year 4	6	0	0	0	0	6
Year 5	0	0	0	0	0	0

In determining the number of protected employees who would have been terminated, we must take into account the extent to which the above figures reflect terminations of unprotected employees. As discussed above, see p. 118, *supra*, nonunion employees occupying executive, professional, and supervisory positions would have been unprotected under the new agreements. Our examination of the "Erie Lackawanna Railway Company, Black Book", Shannon (D) (Feb. 12, 1981) Ex. 26, EL App. N at 583, convinces us that the figure used by Shannon for nonagreement employees is a fair estimate of the number of surplussed employees who would have been unprotected under the new agreements. Most noncontract employees fall within the categories noted above—and would have been unprotected under the new agreements. We reduce Shannon's figures only slightly, from 310 to 280, to reflect our rough estimates of the number of employees—such as secretarial and clerical employees—that likely would have been entitled to protection, see *id.*

Before applying attrition and rehire rates, we deduct the number of unprotected nonoperating employees from the total number of nonoperating position eliminated as a result of the proffered transactions (Table 21) to obtain the number of protected nonoperating positions that would be eliminated in the proffered transactions. For each year following acquisition, we deduct unprotected employees in numbers roughly proportional

to the total numbers of nonoperating position eliminated in each year:[166]

Table 22

Protected Position Eliminated

Year 1	427 − 126 = 301
Year 2	428 − 126 = 302
Year 3	53 − 28 = 25
Year 4	6 − 0 = 6

As with operating employees, attrition and rehire rates must be applied to these figures to obtain an estimate of the number of employees who would have had to be surplussed to achieve the savings reflected in EL's pro formas.

We accept as a reasonable estimate of the attrition rate for EL nonoperating employees the 13 percent figure used by Shannon. This figure was based on EL's historical attrition rate among nonoperating employees, Shannon (D) (Feb. 11, 1981) Ex. 16 at sheet 36, line 6, EL App. N at 552, and the GPs offered no particularized criticism of the rate. Shannon used a rehire rate of approximately 50 percent, see Shannon workpapers 999021, 999024, 999028, EL App. N at 629, 632, 636. We reject this figure, and adopt instead a rehire rate of 33 percent, for the reasons already discussed. Our application of attrition and rehire rates to the number of EL nonoperating employees potentially adversely affected by the acquisition (Table 22) follows:[167]

Table 23

Position Opened By Attrition

Year 1	1,194 x 13% = 155 + 75 = 230*
Year 2	767 x 13% = 100
Year 3	437 x 13% = 57
Year 4	412 x 13% = 54
Year 5	406 x 13% = 53
Year 6	406 x 13% = 53
Year 7	406 x 13% = 53

* Additional 75 position opened to reflect effect of pre-Day-1 attrition.

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Table 24

Rehires and Nondismissals

Year 1	230 x 33% = 76
Year 2	100 x 33% = 33
Year 3	57 x 33% = 19
Year 4	54 x 33% = 18
Year 5	53 x 33% = 18
Year 6	53 x 33% = 18
Year 7	53 x 33% = 18

Deducting the figures in Table 24 from the number of potentially adversely affected protected EL nonoperating employees (Table 22) provides the number of protected EL nonoperating employees who would have been eligible for labor protection:

Table 25

Dismissed Protected Employees

Year 1	301 - 76 = 225
Year 2	302 - 33 = 269
Year 3	25 - 19 = 6
Year 4	6 - 18 = (12)

We must next determine which of the eligible employees would have elected to receive a lump sum severance payment rather than monthly dismissal allowances. We adopt the same assumptions here that we used in the context of operating employee LPCs, see pp. 129-30, *supra*.

Table 26

Employees Electing Lump Sum Severance Payments

Year 1	225 x 40% = 90
Year 2	269 x 40% = 108
Year 3	6 x 40% = 2

The figures in Table 26 reflect the number of EL nonoperating employees that would choose to receive a lump sum payment. As

in the context of operating employees, we must consider the WJPA benefit formula (Table 8) and our estimate of the distribution of EL nonoperating employees by length of service to calculate the LPCs attributable to lump sum payments made to EL's nonoperating employees:[168]

Table 27

Cost of Lump Sum Payments

Year 1	2 x .25 x $12,419 =	$ 6,210
	4 x .5 x $12,419 =	$ 24,838
	6 x .75 x $12,419 =	$ 55,886
	78 x 1.0 x $12,419 =	$ 968,682
	Total	$1,055,616
Year 2	2 x .25 x $12,719 =	$ 6,360
	5 x .5 x $12,719 =	$ 31,798
	8 x .75 x $12,719 =	$ 76,314
	93 x 1.0 x $12,719 =	$1,182,867
	Total	$1,297,339
Year 3	2 x 1.0 x $13,022 =	$ 26,044
Grand Total		$2,379,000

It remains to calculate the LPCs attributable to paying monthly dismissal allowances to EL nonoperating employees:

Table 28

Employees Receiving Dismissal Allowances Per Year

Year		*1*	*2*	*3*	*4*	*5*	*6*	*7*
Employees	1	135	135	135	123*	105*	—**	—
Dismissed	2	—	161	161	161	161	143*	—**
in Year:	3	—	—	4	4	4	4*	—*

* Rehires, from Tables 24 & 25, deducted from earliest possible group. No rehires deducted from earlier years to avoid double-counting with Table 25.

** Benefits available for only five years.

As in the case of EL's operating employees, we reduce the dismissal allowances paid to employees by 50 percent, which we

think reflects the offset that may be attributed to outside earnings. We also reduce the fifth year of dismissal allowances paid to reflect the terms of the WJPA.

Table 29

Cost of Dismissal Allowances

Year 1	135 x $12,419 =	$ 1,676,565
Year 2	135 x $12,419 =	$ 1,676,565
	161 x $12,719 =	$ 2,047,759
Year 3	135 x $12,419 =	$ 1,676,565
	161 x $12,719 =	$ 2,047,759
	4 x $13,022 =	$ 52,088
Year 4	123 x $12,419 =	$ 1,527,537
	161 x $12,719 =	$ 2,047,759
	4 x $13,022 =	52,088
Year 5*	105 x 60% x $12,419 =	$ 782,397
	161 x 60% x $12,719 =	$ 1,228,655
	4 x 60% x $13,022 =	31,253
Year 6*	143 x 60% x $12,719 =	$ 1,091,290
	4 x 60% x $13,022 =	$ 31,253
Grand Total		$15,969,533
		50%
Total Cost of Monthly Dismissal Allowances		$ 7,984,767

* Only WJPA benefits available after expiration of four year period following acquisition.

(i.) *Fringe Benefits.* As in the context of operating employees we adopt a 17 percent figure as a reasonable estimate of the LPCs attributable to the payment of fringe benefits for EL non-operating employees receiving dismissal allowances:

Table 30

Cost of Fringe Benefits

17% x $15,969,533 = $2,714,820

(ii.) *Relocation Costs.* Application of a $5,000 average relocation cost per relocated employee and a 50 percent rate of relocation among rehired employees provides the following estimates of relocation costs:[169]

Table 31

Number of Rehires per Year

Year 1	76
Year 2	33
Year 3	19
Year 4	18
Year 5	18
Year 6	18
Year 7	4
Total	186

186 x 50% = 93 employees relocated

93 x $5,000 = $465,000 relocation costs

(iii.) *Displacement Costs.* Based on the assumptions discussed above, we calculate that LPCs attributable to the payment of displacement allowances to EL's nonoperating employees would have totalled approximately:

Table 32

Displacement Costs

1194 x 12% = 143 displaced employees

143 x $76.28 per displaced employee = $10,900

(iv.) *Total LPCs Attributable to EL's Nonoperating Employees.* Addition of the LPCs attributable to lump sum payments (Table 27), monthly dismissal allowances (Table 29), fringe

benefits (Table 30), relocation expenses (Table 31), and displacement expenses (Table 32) provides the following figure for total LPCs attributable to EL's nonoperating employees:

Table 33

Total LPCs Attributable to EL Nonoperating Employees

Lump Sum	$ 2,379,000
Dismissal	$ 7,984,767
Fringe Benefits	$ 2,714,820
Relocations	$ 465,000
Displacements	$ 10,900
Total	$13,554,487

Addition of the LPCs for operating and nonoperating EL employees produces an estimate of total EL LPCs of $24,793,108.

2. *Lehigh Valley*

We base our calculations of LV's LPCs on a study prepared by W. Arthur Grotz,[170] which we adjust to reflect our disagreement with various of the author's assumptions and choices of methodology. For the reasons discussed previously, see pp. 120-22, *supra*, we reject the GPs' study.

The starting point for Grotz's analysis was a manning study estimating the number of employees that would have been required to operate the LV system following acquisition. Grotz (S) (Oct. 15, 1980) at 15-16. Grotz estimated that 2,161 employees would be needed to run the LV system immediately following acquisition, *id.* at Table 2, and that 2,098 of these positions would be available for protected LV employees, *id.* Grotz concluded that 389 protected LV employees would be terminated as of the date of the acquisition, that 91 employees aged 64 or older would be terminated, and that 120 unprotected LV employees would be terminated, *id.* at Table 1. Grotz estimated

that an additional 116 employees would be terminated in the years following the acquisition.

We accept Grotz's conclusions regarding the number of employees that would have been terminated on "Day 1", the date of the proffered transaction. Grotz's conclusions were based on estimates of LV's future employment requirements—which we find to be reasonable. Grotz had considerable experience in the field of railway economics and was particularly well-informed regarding LV's system. Moreover, his study considered the effects of acquisition on each of the various categories of LV's workforce. We note also that Grotz's estimates of the numbers of adversely affected LV employees were larger than those of Kasher.[171]

Despite our agreement with Grotz's conclusions regarding Day 1 dismissals, we do not think an acquirer's management would have treated dismissals after Day 1 in the same fashion that Grotz's study did. In addition to the elimination of employment positions on Day 1, Grotz projected substantial reductions in the size of LV's workforce in the years following acquisition. Grotz concluded, however, that virtually no employees would be adversely affected as a result of these reductions in available positions on the LV system. Rather, Grotz implicitly assumed that all positions vacated through attrition in a given year could be permitted to remain open throughout that year in order to meet the reductions in employment projected for the next year, *id.* at Table 3. Thus, the number of positions opened by attrition was not reduced to reflect the fact that not all such positions could be filled with employees otherwise scheduled for dismissal, *id.* We think an acquirer would have adopted a less optimistic methodology in projecting its LPC liability under the new agreements. An acquirer's management would have recognized the serious obstacles to using attrition to reduce LPCs. In the words of the ICC, "practical limitations [such] as geography or personal qualifications would restrict the universal transfer and use of employees". *Pennslyvania R.R.—Merger—New York Central R.R.,*

327 I.C.C. 475, 689 (1966). A leading commentator in the field has observed that there is "no certainty that the skills or geographic locations of the employees who were expected to separate from the railroad would match the skills of the employees actually affected by the consolidation". Ables, *supra*, at 118. Likewise, discussing an almost identical issue, the Supreme Court has written:

> According to the findings of the hearing examiner in this case, 863 employees will be totally deprived of employment during the five-year period following the merger. Appellants argue that there is no need for these discharges since natural attrition will open up many more than 863 jobs during the same period. However, as the railroads point out, attrition does not work in a uniform or predictable manner and there is no indication that the elimination of surplus posts can be accompanied by the method appellants suggest. . . .

Maintenance of Way Employees v. *United States*, 366 U.S. 169, 178n.11 (1961).

We think these considerations, and a desire to avoid underestimating LPCs, would have prompted an acquirer's management to adopt a methodological approach to attrition similar to that we adopted earlier in calculating EL's LPCs. Only a portion of the positions vacated each year due to attrition would be considered available to reduce the number of dismissals projected for the following year: thus, a rehire or nondismissal rate would be applied to attrition-vacated positions to determine how many of these openings realistically could have been used to reduce the number of LV employees who would be terminated.[172]

We accept Grotz's use of a 12.53 percent attrition rate. This figure was derived by taking a weighted average of the historical rates of attrition for particular employee age groups that then were applied to the LV workforce, Grotz (S) (Oct. 15, 1980) at

23 & Table 4, and we see no basis for questioning Grotz's determination.

Although we applied a 33 percent rehire rate in calculating EL's LPCs, we adopt a 40 percent rate in LV's case. We think this, or an equivalent, adjustment would have been adopted by an acquirer to reflect the lesser impact of geographical limitations attributable to the smaller size of LV's system. Based on the assumptions and choices of methodology set forth above, we think an acquirer's calculations of the LPCs attributable to the LV system would have proceeded roughly along the following lines.

Based on Grotz's Tables 2 and 3, we estimate that the following numbers of protected positions would have been eliminated in the years following the proffered acquisition:[173]

Table 34

Protected Positions Eliminated Following Acquisition

4/76	389
10/76	112
10/77	206
10/78	133
10/79	100
10/80	0

These figures must be adjusted to obtain an estimate of the number of employees who actually would have been surplussed to achieve Grotz's forecast employment reductions:

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Table 35
Positions Vacated Through Attrition

4/76	2161 x 12.53%=271*
10/76	2015 x 12.53%=252
10/77	1809 x 12.53%=227
10/78	1676 x 12.53%=210
10/79	1576 x 12.53%=197
10/80	1576 x 12.53%=197
10/81	1576 x 12.53%=197

* Calculations reflect 12 months attrition to account for six months of pre-Day 1 attrition, assumed available to reduce Day 1 dismissals.

Table 36
Rehires and Nondismissals

4/76	271 x 40%=108
10/76	252 x 40%=101
10/77	227 x 40%= 91
10/78	210 x 40%= 84
10/79	197 x 40%= 79
10/80	197 x 40%= 79
10/81	197 x 40%= 79

Deducting the figures in Table 36 from the reductions projected in LV's available employment positions (Table 34) provides the number of protected LV employees who would be eligible for labor protection benefits under the new agreements:

Table 37
Protected Employees Dismissed

4/76	389—108=281
10/76	112—101= 11
10/77	206— 91=115
10/78	133— 84= 49
10/79	100— 79= 21

We must next determine which of the employees eligible for labor protection (Table 37) would have elected to receive a lump sum separation payment rather than a monthly dismissal allowance. We reject Grotz's use of a 50 percent figure representing the proportion of employees choosing lump sum separation payments, and adopt instead the 40 percent figure used in calculating EL's LPCs, see pp. 129-30, *supra*.

Table 38
Employees Electing Lump Sum Separation Payments

4/76	281 x 40%=112
10/76	11 x 40%= 4
10/77	115 x 40%= 46
10/78	49 x 40%= 20
10/79	21 x 40%= 8

We next consider the WJPA benefit formula (Table 10) and the distribution of LV employees by length of service, see Grotz (S) (Oct. 15, 1980) at Table 5, 8, to arrive at a figure for the LPCs attributable to lump sum payments to LV's employees:[174]

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Table 39
Lump Sum Payments

4/76	.25	x 2 x	$11,847	=	$	5,924
	.5	x 5 x	$11,847	=	$	29,618
	.75	x 8 x	$11,847	=	$	71,082
	1	x 97 x	$11,847	=	$	1,149,159
10/76	.75	x 1 x	$11,988	=	$	8,991
	.1	x 3 x	$11,988	=	$	35,964
10/77	.25	x 1 x	$12,276	=	$	3,069
	.5	x 2 x	$12,276	=	$	12,276
	.75	x 3 x	$12,276	=	$	27,621
	1	x 40 x	$12,276	=	$	491,040
10/78	.5	x 1 x	$12,571	=	$	6,286
	.75	x 1 x	$12,571	=	$	9,428
	1.0	x 18 x	$12,571	=	$	226,278
10/79	.75	x 1 x	$12,874	=	$	9,656
	1.0	x 7 x	$12,874	=	$	90,118
Total					$	2,176,510

The next step in our calculation of LV's LPCs requires computation of the cost of monthly dismissal allowances. We base our calculations upon the numbers of employees electing monthly dismissal allowances (derived from Tables 37 & 38) and the numbers of rehires per year (Table 36):

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Table 40

Employees Receiving Monthly Dismissal Allowances

	4/76	*10/76*	*10/77*	*10/78*	*10/79*	*4/80*	*10/80*	*4/81*	*10/81*
1	169	169	169	169	169	169	169	169	0*
2	—	7	7	7	7	7	0**	0	0
3	—	—	69	69	69	69	0**	0	0
4	—	—	—	29	29	29	26**	26	0**
5	—	—	—	—	13	13	13	13	0**

* Dismissal allowances limited to five years, see Table 41.

** 79 rehires in periods 10/80 and 10/81, from Table 36, assumed to come from earliest groups dismissed that are not receiving WJPA allowances.

Based on these figures, we calculate the LPCs attributable to payment of monthly dismissal allowances.

Table 41

Monthly Dismissal Allowances

4/76-10/76	169 x $11,847 x 50%	= $ 1,001,072
10/76-10/77	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
Total		$ 2,086,059
10/77-10/78	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
	69 x $12,276	= $ 847,044
Total		$ 2,933,103
10/78-10/79	169 x $11,847	= $ 2,002,143
	7 x $11,988	= $ 83,916
	69 x $12,276	= $ 847,044
	29 x $12,571	= $ 364,559
Total		$ 3,297,662

10/79-4/80	169 x $11,847 x 50% =	$ 1,001,072
	7 x $11,988 x 50% =	$ 41,958
	69 x $12,276 x 50% =	$ 423,522
	29 x $12,571 x 50% =	$ 182,280
	13 x $12,874 x 50% =	$ 83,681
Total		$ 1,732,513
4/80-10/80	169 x $11,847 x 50% x 60% =	$ 600,643
	7 x $11,988 x 50% x 60% =	$ 25,175
	69 x $12,276 x 50% x 60% =	$ 254,113
	29 x $12,571 x 50% x 60% =	$ 109,368
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 1,039,508
10/80-4/81	169 x $11,847 x 50% x 60% =	$ 600,643
	26 x $12,571 x 50% x 60% =	$ 98,054
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 748,906
4/81-10/81	26 x $12,571 x 50% x 60% =	$ 98,054
	13 x $12,874 x 50% x 60% =	$ 50,209
Total		$ 148,263
Grand Total		$12,987,086
Outside Earnings		x 50%
Total Dismissal Allowances		$ 6,493,543

In calculating fringe benefits we apply the 17 percent figure used in computing EL's LPCs and applied by Grotz in his study for LV:

Table 42

Fringe Benefits

17% x $12,987,086 = $2,207,805

Rather than assuming, as we did in EL's context, that 50 percent of all employees rehired would incur relocation expenses, we estimate that only 25 percent of the rehired LV employees

would be relocated. We think it likely that an acquirer would make such an assumption to reflect the smaller size of the LV system, and therefore the lesser likelihood of a need for relocation in particular cases. Application of this figure, and an average relocation cost of $5,000 per relocated employee yields the following results:

*Table 43**

Number of Rehires per Year

4/76	108
10/76	101
10/77	91
10/78	84
10/79	79
10/80	79
10/81	39
Total	581

581 x 25% (relocation rate) = 145.25 relocations

145.25 x $5,000 = $726,250 relocation cost

* Source: Tables 36 & 40.

Based on the assumptions discussed in calculating EL's LPCs, see pp. 139-40, *supra,* we estimate that LPCs attributable to the payment of displacement allowances to LV's employees would have totalled approximately:

Table 44

Displacement Costs

2,161 x 12% = 259

259 x $76.28 per displacement = $19,757

Addition of the LPCs attributable to lump sum payments (Table 39), monthly dismissal allowances (Table 41), fringe

benefits (Table 42), relocation expenses (Table 43), and displacement allowances (Table 44), provides the following estimate of LV's LPCs:

Table 45

Total LV LPCs

Lump Sum	$ 2,176,510
Dismissals	$ 6,493,543
Fringes	$ 2,207,805
Relocations	$ 726,250
Displacements	$ 19,757
Total LV LPCs	$11,623,865

3. The Effect of Bargaining and Other Factors on the Amount of the LPC Deductions

The preceding sections set forth what we believe a potential acquirer realistically would have calculated as its liability for EL's and LV's LPCs in the years following the proffered transactions. The acquirers, in negotiations with EL and LV, would have sought a deduction in purchase price for the Ts' properties based on these calculations. The Ts naturally would have resisted these attempts, arguing as they have in this case that LPCs attributable to their systems would have amounted to relatively little.

As noted previously, the acquirers would have made a conservative projection of their LPC liability. Our LPC calculations reflect this attitude, as three examples will illustrate. First, we did not consider the impact that attrition-created openings on an acquirer's lines would have on a T's LPCs. Some of these vacancies no doubt could have been filled by a T's surplussed employees, thus reducing LPCs. Second, our calculations did not attempt to account for measures taken by the Ts in the years preceding acquisition to reduce their workforces in an effort to minimize LPCs.[175] Third, we applied conservative 33 percent

and 40 percent rehire rates to attrition-created vacancies and to positions made available by rehabilitation and capital improvement programs to determine the extent to which these could be used to reduce the number of dismissals, as well as to permit the rehiring of dismissed employees.

Although we are convinced that the assumptions and methodologies we have adopted, or equivalent ones, would have been used by an acquirer, we also recognize that bargaining would likely reduce the size of the LPC reductions, in part because the T could argue that the acquirer's LPC projections were unduly conservative. Two other considerations, however, would have been even more significant in reducing the size of the LPC deduction. First, labor protection payments made by an acquirer to the Ts' former employees would have been deductible by the acquirer for tax purposes. This would have reduced both the actual cost to the acquirer of the labor protection payments and the size of the LPC deduction by 50 percent. Second, because the acquirer would have been receiving a lump sum LPC deduction from the purchase price, we must calculate the present value—as of the date of agreement on the price of the T's lines—of the acquirer's projected after-tax labor protection payments. As developed in Part VII, we use a 9.13 percent discount rate. Application of this rate to the after-tax LPCs attributable to EL and LV employees produces a deduction of $8,320,737 from the EL purchase price and a $3,929,441 deduction from the LV purchase price.

These figures represent the approximate size of the LPC deduction from the purchase prices for EL's and LV's properties. Competitive bidding and the willingness of the potential acquirers to make some adjustments in the size of the LPC deduction to reflect the possibility that their LPC calculations were unduly pessimistic might have reduced the figures slightly, to $8,300,000 and $3,900,000. The acquirers would not have been likely to agree to further reductions, because of their fears that LPCs would exceed even their pessimistic projections, as had occurred in other situations.[176] We do not assert that these estimates are

exact. The unpredictable nature of the bargaining process and the uncertainty surrounding attempts to predict labor protection costs would frustrate any such effort. We are satisfied, however, that our estimates reasonably approximate the outcome of negotiations among EL, LV, and the acquirers.

4. *Ann Arbor*

AA contends that it would have incurred no LPCs in the alternative scenario because all its properties would have been acquired by the State of Michigan or private purchasers, and reductions in AA's workforce therefore would have been minimal or nonexistent. AA at 183-84. The GPs argue that, even assuming such an acquisition, the prices paid for AA's lines would reflect a LPC deduction. The GPs reason that the State of Michigan would pay only slightly more for AA's northern properties than AA's "next best marketplace alternative". This alternative, the GPs correctly point out, would have been abandonment. Accordingly, the GPs conclude, the LPCs that would result from this abandonment would be deducted from the purchase price for the northern properties. AA responds that neither existing labor protection agreements—principally the WJPA—nor ICC decisions provide a basis for concluding that it would have incurred labor protection obligations had it pursued its next best marketplace alternative. Because of the unusual context in which disputes regarding these agreements and decisions would have occurred—negotiations between the State of Michigan and AA regarding a purchase price for AA's properties—we address separately AA's contentions regarding these issues.

Earlier in this Part we concluded that substantial uncertainty would have surrounded the question whether the WJPA was applicable to the proffered transactions. We think, for the reasons noted above, that similar uncertainty would have characterized negotiations between the State of Michigan and AA. We

also concluded that the ICC's line of *Okmulgee* decisions likely would have been considered distinguishable from the circumstances of the alternative scenario. AA, however, had less trackage (185.4 miles total; 131.2 miles to be abandoned) than some of the railroads involved in the *Okmulgee* cases. For example, the Tennessee Central was 287 miles long, and the Rutland was 332 miles long. Moreover, the relatively isolated and small-scale dismissals that such an abandonment would entail would not have presented a particularly compelling case for ICC insistence that AA proceed under §5(2).

Nonetheless, the State of Michigan could have pointed to a number of ICC precedents which strongly suggest that some sort of labor protection conditions would have been applied had AA pursued its next best marketplace alternative. As the GPs note, in circumstances where an abandonment—even of an entire line—is closely linked to financial gain to the controlling interests of a railroad, the ICC has imposed labor protection conditions pursuant to §1(18) of the Interstate Commerce Act. *E.g., Washington & Old Dominion R.R.—Abandonment of Entire Line,* 331 I.C.C. 587, 600-02 (1968); *Seaboard Air Line R.R. Trackage Rights—Atlantic Coast Line R.R.,* 324 I.C.C. 506, 520-22 (1964); *East Caroline Ry. Abandonment of Entire Line,* 324 I.C.C. 506, 520-22 (1964). This line of decisions—which is at times difficult to reconcile with the *Okmulgee* decisions—would have provided a basis for the State of Michigan to argue that AA would have been saddled with labor protection obligations in the next best marketplace alternative scenario. Moreover, the State of Michigan could have argued that the private acquirer of AA's Toledo-Ann Arbor segment might well have conditioned its purchase on AA's proceeding under §5(2)—in order to receive the antitrust immunity conferred by §5(11). Lastly, we think that the State of Michigan could have argued persuasively that labor unions, through the threat of

strikes and unrest, could have obtained some sort of labor protection commitments from either AA or the acquirers, even without relying on existing agreements or ICC actions.

These considerations indicate that some LPCs would have been incurred in AA's next best marketplace alternative scenario. The labor protection payments likely would have been made by the acquirer of AA's Toledo-Ann Arbor segment. The acquirer would have been willing to assume the obligation for LPCs, in return for a deduction from the purchase price for AA's southern properties, in order to minimize the risk of labor unrest on the acquired southern lines. Moreover, the acquirer would have recognized that the ICC might require that it bear responsibility for labor protection payments. This outcome is suggested by ICC decisions under §1(18) in which carriers absorbing an abandoning carrier's lines were required to make labor protection payments to the abandoning carrier's employees. See *East Caroline Ry., supra,* 331 I.C.C. at 507; *Seaboard Air Line R.R., supra,* 324 I.C.C. at 800-01.

The above considerations would have provided the State of Michigan with substantial leverage in negotiations with AA regarding a purchase price for its northern properties. AA's only bargaining power would have derived from a threat to abandon its northern segment. Actual abandonment, however, would have required AA to risk the ICC's imposition of labor protection obligations or the labor union's successful enforcement of existing labor protection agreements. Moreover, it could have resulted in labor unrest that would have jeopardized the rail use sale of the Ann Arbor-Toledo line. We think it unlikely that AA would have been willing to engage in such brinksmanship. Rather, it would have stayed at the bargaining table arguing for a reduction in the size of the State of Michigan's LPC deduction. The threat of abandonment would have been a relatively weak bargaining tactic in these circumstances.

The GPs contend that AA's LPCs would have totalled $2,197,000 if the ICC had imposed *New Orleans* conditions,

Kasher (S) (Nov. 1, 1979) at 50 and $1,374,000 if the WJPA had applied, *id.* at 51. The estimates assume that AA's lines would have been acquired in mid-1974, and that labor protection obligations would have extended from that date until mid-1978 and mid-1979 respectively. Figures in this neighborhood would have provided the starting point for negotiations between AA and the State of Michigan. Because we have concluded that AA's bargaining position would have been inferior to that of the State, we think AA would have been unable to obtain any significant concession from the State's LPC calculations. We do think, however, that the uncertainty surrounding the likely outcome of ICC action in the next best marketplace alternative scenario would have resulted in some concessions by the State, ultimately leading to a compromise agreement basing estimates of LPCs on the WJPA, rather than the *New Orleans*, level of benefits. This conclusion is also supported by the fact that the GP's calculations of AA's LPCs assumed a mid-1974 disposition, while bargaining between AA and the State of Michigan would have assumed an April 1, 1976, acquisition. A later acquisition date would have permitted AA to take measures to minimize LPCs. Accordingly, the $1,190,000 figure cited above would have provided the basis for the LPC deduction for AA's northern lines.

As in the case of EL and LV, this figure would have been reduced by 50 percent to reflect the deduction of labor protection payments for tax purposes. This conclusion follows from the fact that, in the next best marketplace alternative scenario, the acquirer of AA's southern segment would have assumed responsibility for AA's LPCs in return for a LPC deduction from the purchase price for the southern segment. As in the case of EL and LV, the acquirer could have deducted its future labor protection payments for tax purposes. This would have reduced the LPC deduction the acquirer could have obtained from AA, thus increasing the amount AA could realize in the next best marketplace alternative scenario—and the amount the State of Michigan would be required to pay for AA's properties.

This figure also must be discounted to present value as of January 1, 1974. As we have elsewhere, p. 163, *supra*, we use a 9.13 percent discount rate, which we apply to the annual after-tax LPCs reflected in the GPs study. Kasher (S) (Nov. 1, 1979) at 51. Although these figures may be somewhat overstated as regards AA's LPCs under the WJPA, because they assume a mid-1974 acquisition date, we think they are adequate as regards AA's LPCs in a 1976 acquisition under the *New Orleans* conditions. We calculate that bargaining between AA and the State of Michigan would have resulted in an agreement that the present value of AA's LPCs as of January 1, 1974, would have been $493,200.

5. *Lehigh & New England*

As discussed below, we conclude that L&NE's system would have been sold for no more than X. Accordingly, as we have noted earlier, L&NE would incur no labor protection expenses. This conclusion follows from the fact that L&NE could scrap its lines completely and thus incur no labor protection obligations.[177] Thus, an acquirer would be obliged to offer L&NE at least the scrap value of its lines and to agree to hold L&NE harmless from labor protection expenses to prevent it from actually abandoning.

X. Timing and ICC Conditions

The element of timing is perhaps this opinion's most "prodigious and time-consuming effort in conjecture", *CMV Opinion*, 445 F.Supp. at 1045. It is nevertheless important for several reasons. Delay of a sale much after 1974 would decrease the chance that a prospective purchaser would look only to 1973 as the base year for calculating the earnings value of a given line. Because traffic levels, and hence revenues, declined sharply over all the Ts' lines after 1973, this would have resulted in earnings values significantly lower than ones based exclusively on 1973 data. See pp. 261-62, *infra*. Continuing physical deterioration

of the Ts' rail properties during such delay would have increased necessary rehabilitation costs, which also would have been taken into account by an acquirer. Timing also bears on the amount of labor protection that would have been necessary. See pp. 163 & n.175, *infra*. For these issues, a rough estimate on timing might suffice. But the Ts are entitled to interim interest on any sums they could have realized earlier than April 1, 1976, the date their rail properties were conveyed to Conrail; conversely, the proceeds from a disposition after that date must be discounted back to that date. It is therefore necessary for us to find a precise date by which each T's hypothetical sales probably would have been completed.

We have no illusions about the rigor with which such an inquiry can be conducted. Although the GPs attempt to analyze the stages of the disposition process in grater detail than do the Ts, the parties agree that it would be futile to attempt to write a detailed "history" of the disposition process. See, *e.g.*, 6 GP at Z 9-10; ELRB at 6-7. At best, it is possible only to render a cumulative judgment on how long each broad phase of the disposition process would have been likely to take. As with several other points in this opinion, resolution of the timing issue requires not a "yes-no" judgment of the sort called for in cases requiring determination of historical fact, but rather a choice of one among a number of plausible outcomes. The conventional concept of burden of proof has little meaning in such circumstances. Any particular choice can, in truth, be little more than in impartial guess based upon the evidence and the argument.

We tentatively considered the timing issue in the *CUE Opinion*, 439 F.Supp. 1351, when evaluating the Ts' entitlement to compensation for erosion of their estates due to the compelled continuation of operations at a loss before the conveyance date, April 1, 1976. We held there that such erosion cannot be laid at the government's door unless a T can show that, but for the Rail Act, it would have sought and should have obtained ICC approval to sell or abandon its rail properties before the conveyance date.

The issue of timing therefore became decisive on that of compensable erosion. We stated that the Ts' "burden of demonstrating the probability of obtaining a final decision on and consummating major abandonments or sales before April 1, 1976 . . . will be extremely heavy", 439 F.Supp. at 1375, but left it open for each T to try to do so. 439 F.Supp. at 1374-75, 1379-80. The evidence presented in this phase of the case generally confirms that preliminary judgment. We find that all the Ts' proposed sales and abandonments[178] probably would have been completed on, but not before, April 1, 1976.

A. *The Parties' Positions*

Except for CNJ, whose unique timing arguments we consider and reject at pp. 305-09, *infra*, the various Ts' contentions about the disposition process are consistent with each other. Indeed, the GPs and the Ts do not seriously disagree about the basic steps of the disposition process, at least when those steps are stated in sufficiently general terms. See 6 GP at T 28-29. Each T, including PC and R before their dismissal from the case, claims that it would have sought to dispose of its rail properties as the first of two steps[179] in a plan of reorganization under §§ 77(d) and (e) of the Bankruptcy Act.[180] Those provisions require such a plan to have the approval of both the ICC and the reorganization court.[181] The Ts and the GPs envision each T's disposition process as taking place in three broad phases.

Commencing with each estate's determination to liquidate its rail properties, the first phase would have encompassed the reaching of sale agreements. Each T would have announced a program to dispose of its rail properties by either sale or abandonment and would have solicited expressions of interest from solvent railroads and public bodies. Each potential purchaser would have had to study the costs and benefits of the various possible acquisitions before serious negotiations could take place. Some negotiations would have been complicated by

the need for several interested parties to negotiate with each other simultaneously. For example, no solvent railroad would have purchased any T's lines until it had reached an accommodation with that T's unions over labor protection. Some negotiations would have been wholly contingent on others, as in the case of AA's contention that the potential acquirers of PC's Chicago-Detroit or Detroit-Cincinnati IFLs would have bid for its Toledo-Ann Arbor segment. See AA at 31. Even after the main contours of the reconfigured rail system in the Northeast began to emerge, traffic and revenue projections for many freight lines would have depended in part on the terms on which freight traffic would have had access to connecting lines slated for acquisition by public bodies; similarly, public bodies acquiring parts of the NEC would have had to agree among themselves on how to allocate the costs of intercity passenger service. While these studies and negotiations were taking place, each T would have instituted formal proceedings before the ICC to lay the groundwork for approval of the transactions; they would have filed applications to abandon or sell their entire rail systems at the beginning of the process, submitted to the ICC the data that were being made available to prospective purchasers, and filed applications for approval of specific sales as each was negotiated. At the same time, the ICC would have begun an investigation on its own initiative to develop detailed information about the transportation needs of the Northeast for use in those proceedings.

The parties are in apparent agreement that this first phase of the process, however long it would have taken, would have resolved the question of price. Conceivably, the parties to a sale might have reached only an agreement to agree later on a price, but this is unlikely. None of the parties makes this argument, and the briefs apparently assume that the Ts and their acquirers would have agreed on a price before seeking ICC approval. See, *e.g.*, 6 GP at T 28. In addition, some of the witnesses thought the negotiation phase would resolve the question of price. Whitehurst (S) (Nov. 1, 1979) at 39; Hesse (S) (R Pro' able Actions)

(Dec. 31, 1978) at 18-20. Finally, the ICC, at least to the extent it was proceeding under § 5 of the Interstate Commerce Act, would not have considered an application that did not include a price term. 49 C.F.R. § 1111.1 (c)(2) (1974).

The second phase, partly overlapping the first, would have consisted of the ICC's deliberations over the sales and abandonments. As we discussed in Part IX, *supra,* sales would have been evaluated under § 5(2) of the Interstate Commerce Act; abandonments would have been evaluated under § 1(18).[182] In parallel with these deliberations, the ICC would have conducted any further inquiries into the Ts' financial condition required by the Bankruptcy Act. After giving its approval to the sale and abandonment applications, along with any conditions it saw fit to attach, it would have certified the Ts' plans of reorganization, as modified, to their respective reorganization courts.

The final phase of the disposition process would have encompassed any steps necessary to complete the dispositions after the ICC approved them. At a minimum, § 77(e) of the Bankruptcy Act would have required each estate's reorganization court to hold a hearing on and give its approval to the estate's proposed dispositions. Further time would have been necessary for the Ts and the acquirers to negotiate any changes made necessary by ICC modifications of the proposals as initially submitted and to formalize the sale agreements, and for the acquirers to finalize credit arrangements.

In addition to agreement on the broad steps of the disposition process, there is now no dispute as to when each T would have begun to dispose of its properties. This issue was settled by paragraph 10 of the Second Pre-Trial Order, which provided that "the transferors (including the Trustees of the Erie Lackawanna) are entitled to assume that, in the absence of the Rail Act, serious consideration and discussion of dispositions for continued rail use would have begun not later than February, 1973". Thus, even though EL did not lose hope of achieving an income-based reorganization until January 1975 in the real world, it now believes,

with the other parties, that it would have filed for authority to sell or abandon its freight lines in mid-February 1973 in the alternative scenario. EL assumes that PC would have filed for abandonment in February 1973, and that EL's management then would have realized that Western carriers would have been prompted to purchase PC's IFLs, thereby threatening to divert traffic from EL and dashing its hopes for a successful reorganization. 1 ELF at 19-20. LV, which actually filed a petition for abandonment with its reorganization court in early March 1973, contends that it would have filed at least as soon in the alternative scenario, LV at 20; R would have followed suit sometime in the spring of 1973, 2 RF at 214-15; and AA, which had had an application to abandon its car ferry operations across Lake Michigan pending since 1972, would have applied to the ICC for permission to sell or abandon its rail properties not later than May 1974. AA at 6, 28 n.l.

Although the general framework and the starting point of the disposition process are thus not in dispute, the parties' disagreements over how long each phase of the process would have taken lead to sharp differences at the bottom line. The GPs offer relatively detailed testimony on each phase of the disposition process. Several experts analyzed the time required for potential purchasers to study the proffered lines and for the basic terms of purchase to be negotiated.[183] Others addressed the difficulties involved in the multi-sided negotiations that would have had to take place among the Ts, solvent buyers, and labor;[184] among various Ts, solvent buyers, and public bodies over who would acquire the commuter lines and other lines in the JT areas, and over the switching and trackage fees to be levied by public bodies that acquired such lines; and among the various public bodies that would have acquired segments of the NEC spine.[185] Still others addressed the various tasks the ICC would have had to perform, and the steps necessary to consummate the transactions after ICC approval.[186]

Relying partly on analogies to past sale and abandonment transactions and partly on ad hoc judgments about the transactions involved here, those experts concluded that at least three-and-one-half to four years would have been necessary for potential buyers and labor to complete necessary studies and reach agreement with the transferors, see 6 GP at T50-52, 58-64, 94-96; that at least four-and-one-half to five years would have been necessary to obtain ICC approval for the transactions, see *id.* at T 104; and that at least eight months would have been necessary to complete the transactions after final ICC action, see 6 GP at T 147-52. Assuming that PC began its disposition process in February 1973, these figures would point to a completion date no sooner than October 1981. The GPs choose to err on the side of generosity and argue for a completion date no sooner than late 1978 or early 1979.

Underlying the GPs' timing case are three vital premises. First, the GPs contend that the federal government would have been willing to provide to the Ts for an indefinitely long period whatever aid was necessary to prevent them from shutting down for want of cash. Second, they contend that Congress would neither have imposed time limits on the ICC's deliberations nor have altered the ICC's substantive legal mandate for the occasion. Finally, the GPs contend that the ICC would not have considered each T's sale and abandonment applications in isolation, but rather would have consolidated all the proceedings in order to evaluate the effect of each proposed transaction on the others and on the region as a whole. The effect of this last contention is to slow each disposition process at least to the pace of the slowest T, which, because of its size and complexity, inevitably would have been PC.

The Ts' timing cases (including that of PC, whose timing evidence the Ts remaining in the case generally adopt) rest on the negation of these three premises.[187] Their primary argument is that Congress would not have provided them with any financial aid, and that their dispositions therefore would have to have been

completed before they ran out of cash and had to cease operations. Content to argue that because potential buyers, labor, and the ICC could not tolerate a shutdown, they would have found some way to complete the transactions before the Ts became cashless, the Ts eschew discussion of supposedly analogous historical transactions, and they offer little testimony about the details of each phase of the disposition process. Under this theory, PC, LV, and R equate their disposition dates roughly with the date by which each would have run out of cash: July 1974, March 1974, and mid—1974, respectively.[188] AA, rather differently from the others, claims that it would have become cashless in May 1974, but does not deny that it would have received interim aid from either the state or federal government; rather, it contends that it could have completed its dispositions by the spring of 1975 because all of its potential acquirers were familiar with its operations and hence would have needed little time to formulate a bid, and because none of its dispositions would have been opposed before the ICC. EL, true to its theory that its disposition process would have paralleled that of PC, links its disposition date to PC's. PC and EL thus project completion of their disposition processes roughly eighteen months after their determination to liquidate; the others project even faster dispositions. Partly in support of their cashlessness argument and partly as a fallback, the Ts argue that Congress would have imposed a deadline on the ICC's deliberations or drastically changed its legal mandate. Failing that, they argue, the reorganization courts would have imposed deadlines on the ICC. Finally, several Ts deny that the ICC would have consolidated their applications with those of PC or other Ts.

Appendix H

B. *Analysis*

1. Likely Congressional Initiatives in the Alternative Scenario

The most serious source of uncertainty in any inquiry into the disposition process lies in estimating the likely behavior of Congress in the alternative scenario. We specifically opened the door to argument on this issue in the *CMV Opinion*, 445 F.Supp. at 1008-09, and suggested that Congress might have provided "interim financial aid" to the Ts or enacted "regulatory reforms". The GPs and the Ts both contend that Congress would have undertaken special initiatives shortly after the Ts began their liquidation programs, but they focus on different halves of this suggestion. The GPs posit an open-ended program of operating subsidies designed to keep the Ts afloat during an indefinitely prolonged disposition process. At the same time, they reject any argument that Congress would have attempted to shorten the process by imposing a deadline for ICC action or by changing its mandate. The Ts' position is the opposite of the GPs': they contend that Congress would have granted them no interim aid, but would have placed time limits and other constraints on the ICC's deliberations. Their argument against interim aid implicitly depends on a single premise: that Congress would have realized that the Ts' dispositions could be completed speedily if the potential acquirers, interested third parties, and the ICC were all forced to meet the deadline imposed by the Ts' imminent shutdown for want of cash.

The Ts make a plausible case that extremely fast dispositions, on the order of eighteen months, might have been feasible if Congress had been absolutely determined to force such an outcome. Nevertheless, we think it almost certain that Congress would have chosen to lengthen the disposition process to some extent, and therefore would have provided some form of emergency aid to the Ts. The Ts do not deny that Congress' primary motive in the alternative scenario would have been to maximize

the likelihood that the Ts' lines would remain in rail use. See 2 RF at 255-57. According to the premise laid down in the *CMV Opinion*, 445 F.Supp. at 1005, we must assume that Congress would not have ensured that outcome by acquiring the lines for the federal government; hence that motive would have manifested itself by actions designed to maximize the chance that sales such as those the Ts propose would be consummated. But Congress would have seen that the speedy disposition schedule the Ts propose could backfire, for, as the GPs' evidence shows, potential bidders, particularly solvent railroads, might simply have refused to bid at all if they were not given enough time to perform the studies necessary to form a rational judgment about the value of the Ts' lines. See 6 GP at T 177. The Ts' evidence does not rebut this; it purports to show only that potential bidders could have met the Ts' schedule if forced to do so. That evidence does not bear on whether Congress would have risked that experiment. In deciding whether more time than the eighteen months allowed by the Ts would have improved the likelihood of substantial rail use sales, Congress would have been entitled to look to prior sale and abandonment transactions. The Ts, however, cite no transaction that was anywhere near the size and complexity of the ones PC alone would have undertaken and was completed in anywhere near the eighteen months they postulate, and the GP's survey of prior transactions demonstrates that much simpler transactions commonly took far longer. See 6 GP at T 152. Congress could hardly have escaped the conclusion that more time would have substantially helped the chances for a successful disposition.

Apart from the objective reasonableness of providing for a longer disposition process, we are persuaded that it would have been inevitable as a matter of political reality. Representative members of most affected interest groups—shippers, labor, and state and local governments—testified persuasively and without effective contradiction that they would have demanded that Congress provide enough interim aid to allow for a disposition process long enough for them to sort out their options and organize an

effective defense of their interest before the ICC. See 6 GP at T 167-172.[189] Such efforts could not have been effective until the Ts' sale and abandonment plans were completely negotiated and set out before the ICC. If, as we find below, that would take a minimum of a year, then at most six months of the Ts' eighteen-month schedule would remain for ICC proceedings. Even if the ICC could have met its statutory obligation to afford a "reasonable opportunity for interested parties to be heard", Interstate Commerce Act § 5(2)(b), 49 U.S.C. § 11344, in that period, which we doubt, these constituent group would have argued to Congress, with much justice, that the ICC could be little more than a rubber stamp for the Ts' proposals in such a condensed proceeding. With virtually every constituent group but the Ts themselves clamoring for more time to prepare their cases, Congress would inevitably have responded. For the same reason, while some of the Ts suggest that Congress would have curtailed the ICC's role in the disposition process or eliminated the right of third parties to be heard, we agree with the GPs' experts that such a move would have been politically unlikely. This is the price the creditors of the Ts' estates would have paid for living in a democracy. *See CUE Opinion,* 439 F.Supp. at 1373. We therefore find that Congress would have allowed more time for the disposition process than the eighteen months for which the Ts argue, and hence would have provided the Ts with at least some interim financing.

On the other hand, we also reject the GPs' contention that Congress would have provided such aid without limit as to time or amount. Congress would have had to announce a deadline on interim aid if it wanted sales to be negotiated at all. To show this, it is necessary to note only that some of the sales would be of admittedly losing operations to public bodies, and that none of the sales could take place without the acquiescence of labor unions. Common sense and the GPs' own evidence both indicate that neither labor nor public bodies would have agreed to do those things unless and until faced with the even worse prospect of

imminent shutdown. The GPs suggest no reasons why these actors would not have been content simply to put off the evil day as long as the federal government was willing to subsidize continued operations.[190] Under the principles stated in the *CUE Opinion*, however, the government could constitutionally have forced the Ts to continue their hopelessly losing rail operations, while their estates continued to erode, only if the government could show a certainty or a high likelihood that the erosion would cease within a reasonable time.[191] We have grave doubts whether it could have made that showing before the Ts' reorganization courts if it had followed the course the GPs suggest.

We need not go so far as to hold that a reorganization court would have been justified in granting a T immediate permission to shut down. It is enough to say that Congress would have been aware that the indefinite continuation of interim aid would have created a danger of triggering a court-ordered shutdown. See *CUE Opinion*, 439 F.Supp. at 1377-78.[192] But Congress was acutely sensitive to that danger in the real world, see *id.* at 1361; Northeast and Midwest Railroad Transportation Crisis: Hearings Before the Subcommittee on Surface Transportation on S. 2188, 93d Cong., 1st Sess. 886-87 (1973) (comment of Mr. Adams), and, as the GPs' own evidence shows, preservation of essential rail service would have been its overriding priority. Clausen (S) (Nov. 1, 1979) at 3-4. Hence, we are certain that it would have avoided that danger by announcing, in advance, a date in the reasonably near future after which it would cease to subsidize the Ts, thereby forcing all necessary actors to agree by that date. In effect, Congress would have been forced to write the sort of "essay in brinksmanship" we condemned on the part of the Ts in the *CUE Opinion*, 439 F.Supp. at 1379.[193]

Apart from fears of a court-ordered shutdown, Congress would have had more mundane reasons to place a deadline on the negotiation process. The GPs' thesis requires us to believe that Congress would have knowingly opened the federal treasury to a drain of unknown but very substantial size for an indefinite period,

ceding all control over the duration of the subsidy to any necessary actor that chose to be intrasingent, and without any assurance of a desirable result.

The record supports our conclusions. Aage Clausen, the GPs' main witness on congressional actions in the alternative scenario,[194] correctly stated that "[e]vidence of prior Congressional action is the best predictor of how Congress would have acted in the period under consideration". Clausen (S) (Nov. 1, 1979) at 9. Of the rail legislation analyzed by Clausen, however, none committed the federal government to provide substantial aid to privately owned railroads without retaining strict control over its amount, duration, and use. None is remotely like the open-ended commitment to underwrite operating deficits that the GPs' thesis requires.[195] To be sure, Congress would have needed to give potential acquirers enough time for study so that they could submit rational bids, since they might otherwise have balked at bidding at all. It would also have needed to allow some time for the voluminous details of the transactions to be negotiated. But there is no evidence, and no reason to believe without evidence, that any time beyond this bare minimum would have made sales for rail use any more likely. Hence there would have been no reason for Congress to spend substantial amounts of taxpayers' money on subsidies for any longer period.

For similar reasons, we are persuaded that Congress would have placed a time limit on the ICC's deliberations. The fact that Congress placed a deadline on the USRA's creation of the Final System Plan in the real world is a strong indication of that, for while the USRA formulated its plan, Congress was providing much the sort of subsidy that would have been necessary in the alternative scenario. Congress would probably have seen it as far less expensive to hasten the ICC's deliberations by expanding its staff for the occasion, concentrating the same resources that in the real world went into the creation of the USRA and the ICC's Rail Services Planning Office, and expansion of the Department

of Transportation, than to pay operating subsidies to the Ts for an extended period.

Even aside from its wish to protect the public purse, we doubt that Congress would have relied on the ICC's normal procedures without giving it some kind of prod. Congress showed its mistrust of those procedures at the time of the rail crisis and on many occasions thereafter. Its rejection of the ICC's proposed solution to the rail crisis and creation of an entirely new agency to draw up the Final System Plan were partly due to the mistrust engendered by the Commission's traditional delays.[196] At the same time that it provided interim aid, Congress would have set time limits on the ICC's deliberations. Congress repeatedly passed legislation imposing deadlines on the ICC's handling of sale and abandonment applications relatively soon after the Rail Act, as discussed in detail below. The first such deadline, enacted in the Railroad Revitalization and Regulatory Reform Act of 1976, was proximately inspired by the ICC's unusual delays in handling the Penn Central and Rock Island merger applications. See Corber (D) (July 7, 1980) at 128-30, EL App. K at 198-200; S. Rep. No. 499, 94th Cong., 2d Sess. 19, *reprinted in* [1976] U.S. Code Cong. & Ad. News 14, 33. But the Penn Central merger had been completed and the Rock Island had already dragged on for ten years by 1973. Thus there is no reason to expect that Congress' actions in the alternative scenario would not have been guided by the same inspiration. GP witness Robert Corber, formerly a Commissioner of the ICC, admitted that Congress "would have urged the Commission to promptly dispose of the applications in the proceedings that were before it". Corber (D) (July 7, 1980) at 137, 8 RF App. at Ex. 77. Given its record of placing deadlines when it considered speed important, we cannot believe that it would have relied on moral suasion alone.

The GPs advance little evidence to the contrary. Virtually all of their experts assume that we ruled out the possibility of such legislation. See, *e.g.*, Corber (D) (July 7, 1980) at 80-82, EL App. K at 195-196; Brooks (D) (July 14, 1980) at 74-75, EL

App. K at 214-215. In fact, in the *CMV Opinion*, 445 F.Supp. at 1008-09, we explicitly ruled it in.[197] Although some witnesses testified, and we have held, that pressure from shippers, labor, localities, and other interested parties would have prevented Congress from cutting off their right to participate in ICC proceedings or from making drastic changes in its substantive mandate, see 6 GP at T 168-72, this factor does not proscribe time limits. Indeed, those same pressures did not prevent Congress from passing the ICC reform legislation we noted above. As the ICC's experience under those reform statutes shows, its procedures could have been expedited considerably without drastic changes in its mandate. For example, although interested parties have a statutory right to submit evidence and argument in sale and abandonment proceedings, the GPs concede that they have no statutory right to submit it orally. See 6 GP at T 122. The ICC could have limited or dispensed with hearings, as it already did for certain classes of cases, see Brooks (D) (July 14, 1980) at 164, 7 RF App. Ex. 71, and it could have placed a time limit on submission of written evidence and argument, see Milwaukee Road Abandonment Proc., 44 Fed. Reg. 50975. Similarly, it could have dispensed with initial hearings before an administrative law judge. See Brooks (S) (Nov. 1, 1979) at 16. Preparation of an environmental impact statement as required by the National Environmental Policy Act (NEPA) could have been a lengthy process. Congress, however, granted exemptions from NEPA in the Rail Act and in two ICC reform statutes aimed specifically at expediting deliberations over sales and abandonments proposed by railroads in reorganization. Milwaukee Railroad Restructuring Act, § 19, 45 U.S.C. § 917; Rock Island Railroad Transition and Employee Assistance Act, § 113, 45 U.S.C. § 1010. These statutes, combined with Congress' frequent practice of granting NEPA exemptions when time is of the essence and to particularly complex transactions, see, *e.g.*, Trans-Alaska Pipeline Authorization Act, 43 U.S.C. § 1652(d); Alaska Natural Gas Transportation Act, 15 U.S.C. § 719(h)(c)(3), convince us that a similar

exemption would have been provided here, especially since continuation of rail service rather than its abandonment and replacement by trucks and buses was obviously in the interest of the environment.

The principles that would have guided Congress are thus relatively clear. Estimating the numbers it would have chosen is more difficult. With respect to the time limit it would have placed on the ICC, the deadline imposed on USRA in formulating the Final System Plan is highly pertinent, for USRA dealt with the same properties that would have been before the ICC. That deadline was originally fifteen months, later extended to nineteen months because of delay by President Nixon in appointing the Board of USRA, see *CUE Opinion,* 439 F.Supp. at 1363. See Rail Act § 207(c). That extension would not have been necessary in the alternative scenario.

We stressed in the *CUE Opinion,* 439 F.Supp. at 1373-74, 1375, differences between the task that actually faced USRA and the one that would have faced the ICC. See also *180-Day Appeals,* 384 F.Supp. at 922. While they are undoubtedly substantial, on further reflection they are not so great as we there portrayed them. Indeed, in one important respect the ICC's task would have been the simpler one: a basic outline of what rail lines would stay in rail use and who would own them would have been presented to it as a product of negotiations. By contrast, USRA had to design a rail system for the Northeast from scratch. It had not only to decide what would stay in rail use and what would not, but also who would own what lines; it had to negotiate with solvent railroads to persuade them to acquire lines, see 3 GP at I 28-34; and it pondered alternative structures for Conrail itself, *180-Day Appeals*, 384 F.Supp. at 958 n.73. It managed to meet its deadline even though a major carrier, EL, was thrown into its lap only three months before the deadline, see *CUE Opinion*, 439 F.Supp. at 1386-87. Furthermore, we did not envision the possibility of regulatory reform at the time of the *CUE Opinion.* NEPA, which we viewed as a major stumbling block for the ICC,

439 F.Supp. at 1374, probably would have been rendered inapplicable to the ICC as it was to USRA. The ICC's "time consuming hearing requirements", *id.*, are less onerous than we then imagined, given that it had power to limit the submission of evidence to writing. Even the scrutiny it would have had to give to "considerations of competitive effect", *id.* at 1373, would have been lessened by analogy to the failing company defense of antitrust law, see *CMV Opinion*, 445 F.Supp. at 1009-10.

Still, assuming, as we do, that Congress would not have made major changes in the ICC's legal mandate, Congress would have had to allow at least somewhat more time for the ICC in the alternative scenario than it thought necessary to give the USRA in the real world. The ICC would have had to develop an adequate record to support its decisions on judicial review. *Swift & Co.* v. *United States*, 343 U.S. 373, 381-82 (1952); *I.C.C.* v. *Union Pacific R.R.*, 222 U.S. 541, 547-48 (1912). By comparison, the Final System Plan was not subject to judicial review, but only to review by Congress, see Rail Act §§ 208(a), 209(a)—and Congress was doubtless more interested in the USRA's results than in its reasons. Although its hearings could have been conducted mostly or entirely on paper, the ICC would have been bound to consider each argument raised by the scores of interested parties who certainly would have intervened. Solvent railroads that had bid unsuccessfully on a given line would have tried to convince the ICC that they could provide more or better service, or were in better financial condition, than the high bidder; other solvent railroads would have sought traffic protection conditions, which would have forced the ICC to study possible traffic diversions that might result from the sales; public bodies that were cast in the role of buyers of last resort for hopelessly losing passenger operations would have pressed the ICC to fob them off on the acquirers of potentially profitable freight lines; shippers could have been counted on to contest abandonments; and the ICC would have had to approve the labor protection agreements previously negotiated. We therefore find

that the fifteen months Congress initially allowed USRA constitutes a lower bound on the amount of time it would have allowed the ICC. For the reasons stated in the preceding paragraph, we find it is not a very distant bound.

Further insight can be gained by examining the large number of statutes enacted since the Rail Act that have placed time limits on the ICC's handling of sale and abandonment applications. Most closely analogous are three statutes specifically applicable to railroads in reorganization: the Milwaukee Railroad Restructuring Act, P.L. 96-101, 93 Stat. 736 (1979), the Rock Island Railroad Transition and Employee Assistance Act, P.L. 96-254, 94 Stat. 399 (1980), and the provisions of the new Bankruptcy Code applicable to railroads in reorganization, 11 U.S.C. §§ 1170, 1172. Section 5 of the Milwaukee Act, 45 U.S.C. § 904, transfers all jurisdiction over abandonments by the Milwaukee Railroad from the ICC to the railroad's bankruptcy court, and authorizes the court to set a time limit of six months, or even less if it chooses, on the ICC's deliberations over sale applications by the Milwaukee; in the latter case, the ICC may act without a hearing if it chooses, *id.* § 5(b)(2), 45 U.S.C. § 904(b)(2). Sections 1170 and 1172 of the Bankruptcy Code closely parallel the Milwaukee Act. Section 1111 of the Rock Island Act, 45 U.S.C. § 1009, fixes a maximum deadline of 100 days for ICC evaluation of sale applications filed by the Rock Island. These very short deadlines show great concern for the rights of creditors of an eroding estate, a concern that could only have been heightened in the non-Rail Act world, for each month's delay by the ICC would have cost the government a substantial amount of interim subsidies. Two enactments place time limits on ICC handling of sale and abandonment applications filed by any railroad, including ones not in reorganization. Section 402 of the RRRR Act placed a basic thirty-one month time limit on ICC consideration of sale and merger applications, although the ICC was empowered to violate that limit, if necessary, upon report to Congress. The Staggers Act of 1980 made that thirty-

one month time limit absolute, and shortened it to ten months for transactions other than mergers and acquisitions of control, which would be the case here.

The thirty-one month deadline set by the RRRR Act and confirmed by the Staggers Act is a plausible upper bound on the amount of time Congress would have allowed the ICC in the alternative scenario. It is contained in statutes of general applicability, and so it was designed to apply even to very large transactions. But for the reasons stated above, we think Congress would have imposed an even tighter time limit than usual in this case.[198] Between the lower bound of fifteen months and this upper bound of thirty-one months, we think that a range of twenty to twenty-four months is a reasonable estimate of the time limit Congress would have set.

Knowledge that Congress' provision of interim aid would be sharply limited in time would also have shrunk the period devoted to studies and negotiations. Shannon testified on behalf of EL that a study sufficient to support a "reasonable business decision" to buy portions of PC or EL could be made in six months. Shannon (D) (May 23, 1979) at 343, EL App. K at 163. That estimate is supported by two objective sources. First, an employee of Norfolk & Western, studying the possibility of a purchase of PC and other Ts by Norfolk & Western, Chessie, other solvent railroads, and public bodies, estimated in June 1973 in an internal memorandum that potential acquirers would be ready to bid within six months. Zeis (D) (May 8, 1980) Ex. 5, EL App. K at 245-246. Second, Chessie began serious negotiations with USRA over purchase of EL, R, and PC lines designated for sale to it by the Preliminary System Plan after only five months of study.[199] That transaction was similar in size and complexity to those in the alternative scenario, since it encompassed essentially all the freight lines in R's rail use proffer, including those originally proposed for the JT, most EL freight lines east of Akron, plus a branch of PC. See 3 GP at I 29. We have elsewhere noted that Chessie's study was a reliable one, see

pp. 85-87, *supra*, and the GPs give no substantial reason why its real-world experience would not have been comparable to what would have obtained in the alternative scenario. Nor do they even attempt to discredit Norfolk & Western's estimate. That neutral and contemporaneous judgment and Chessie's real world experience are far more persuasive to us than the GPs' evidence, which consists entirely of expert testimony prepared for this litigation. We therefore find that five to six months would have been sufficient time for potential acquirers to study the Ts, including PC, before serious negotiations could begin.

Further time would have been necessary for negotiations between the Ts, acquirers, and labor, and for any legislation necessary to enable public bodies to buy the Ts' properties. The evidence on how long would have been necessary to do that is surprisingly scant. The Ts offer virtually none.[200] The GPs consider that the limiting factors would have been labor negotiations and negotiations with public bodies. Several experts testified that labor negotiations would have taken two further years. See, *e.g.*, Myles (S) (Nov. 1, 1979) at 15-22; Luna (S) (Nov. 1, 1979) at 17-18. The one expert who gave a number for public body purchasers stated that they would have needed at least three-and-one-half years for study and negotiations. Whitehurst (S) (Nov. 1, 1979) at 45. We give little credence to this testimony, however, for all of these witnesses followed the GPs' erroneous assumption that unlimited financial assistance would have been available to the Ts. See Myles (S) (Nov. 1, 1979) at 2; Luna (S) (Nov. 1, 1979) at 2; Whitehurst (S) (Nov. 1, 1979) at 9. Furthermore, the GPs' two most important labor witnesses on this issue refused to accept the premise, required by the *CMV Opinion*, that Congress would not have stepped in to save jobs if the Ts had shut down. See, *e.g.*, Luna (D) (June 4, 1980) at 91, 8 RF App. Ex. 79.

As we have discussed elsewhere, labor would have been more pliant in such a situation than its history would suggest. An analogy is suggested by the Miami Accords, discussed at p. 115,

supra, negotiated in only a few weeks, which resolved the labor protection issues arising out of the reorganization of the Rock Island and Milwaukee Railroads. The Miami Accords thus show that labor negotiations can move quickly if the alternative is a complete shutdown.

All things considered, we estimate that the necessary studies could have been made and the Ts could have concluded sale agreements, including agreements on price, within ten to twelve months after PC announced its intention to liquidate. We further estimate that Congress would have set a twenty to twenty-four month deadline on the ICC's consideration of the Ts' sale and abandonment applications.

These conclusions imply that Congress would have had to provide interim assistance to the Ts in some form. We find that aid probably would have been provided in the form of grants, rather than priority loans. That the interim assistance provided for by the Rail Act was in the form of grants is persuasive of this.[201] That choice was not accidental; the legislative history shows that Congress believed that forced priority loans would have been unconstitutional. See Clausen (S) (Nov. 1, 1979) at 37-38. Whether a court should have held such forced loans unconstitutional is a difficult question that we need not decide. It is enough that Congress thought it was; Congress is entitled to give the creditors the benefit of its own understanding of the just compensation clause.

2. *Probable Actions of the ICC*

Our finding that Congress would have been likely to impose time limits on the ICC in the alternative scenario generally spares us the task of reconstructing the likely actions of the ICC in any detail. Nevertheless, two broad clusters of issues require discussion. First, the GPs argue that the ICC would have modified or placed conditions on the sale agreements and abandonment proposals presented to it by the Ts. Each of the modifications and

conditions they propose would have reduced the price the Ts would have realized. Second, the Ts challenge the GPs' assumption, which we have accepted *arguendo* thus far, that the ICC would have consolidated all the Ts' sale and abandonment applications and considered them together in a regional planning process.

(a) *Conditions Reducing Value*

The GPs argue that the ICC would have placed several kinds of conditions on the Ts' applications to sell and abandon their properties. At various points, they argue that the ICC would have required labor protection benefits for displaced employees, imposed traffic protection conditions to prevent undue diversion of traffic from solvent carriers' line, and approved sales of certain lines only if the acquirer agreed also to acquire either other lines slated for abandonment by the Ts or unprofitable lines slated for acquisition by public bodies. They so argue partly to support their timing argument by illustrating the complexity of the ICC's task, and partly because some conditions would in themselves have diminished the amounts the Ts would realize. Insofar as the GPs offer these arguments on the issue of timing, they are subsumed within our conclusion in the preceding section that Congress would have placed a time limit on the ICC's deliberations. Labor protection is discussed in Part IX.[202] Hence, only the contentions that the ICC could have conditioned the sale of some lines on acquisition of less profitable lines or of lines that would otherwise be abandoned need be addressed here.

These contentions lose much of their force because of our finding that the private acquirers of EL's and LV's main freight lines would have acquired those carriers' predominantly freight lines in the joint terminal area as well. See pp. 200-05, *infra*. Except for the contention that the ICC would have required the acquisition of lines slated for abandonment, the only lines to

which the GP's argument now applies are EL's passenger operations and, assuming that a solvent railroad would have been the high bidder for the AA's Toledo-Ann Arbor segment, the AA line north of Ann Arbor. The GPs offer considerable evidence that shippers onlines slated for abandonment and the public bodies slated to acquire these lines would have petitioned the ICC to foist them onto the solvent acquirers of those carriers' other lines. We are persuaded that they would have tried, but we hold that they would have failed.

In the *CMV Opinion* we "record[ed] our disagreement with the suggestion of the Government parties that the Interstate Commerce Commission would or could have used its power to withhold approval so as to insist on the inclusion of unprofitable mileage to a degree that would have driven down the price that purchasers would pay down to the level of scrap value . . ." 445 F.Supp. at 1010 & n.19. Although we also stated that "[w]e do not intimate that the Commission would have had no alternatives other than complete acceptance or rejection of the proposals as made", we had in mind such common conditions as traffic protection, trackage rights, or inclusion of other carriers. With one exception, the cases the GPs cite either involve conventional conditions or simply allude to the ICC's power to impose conditions in general terms; we distinguished those and similar cases in the *CMV Opinion, id.* The sole exception, and the GPs' only specific authority for conditions involving acquisition of unwanted trackage, *Chicago, Kalamazoo & Saginaw Ry. Acquisition,* 166 I.C.C. 265 (1930), is of little precedential value here. The condition imposed in that case required the addition of only two extra miles of track to a purchase of 10.3 miles. Moreover, that case was decided by a division of the ICC and was not reviewed by the full Commission or the courts, and we have neither been referred to nor found in our own research any instance where it has been cited or followed by the ICC in the fifty years since it was decided.

Assuming the ICC had power to condition the Ts' sales to solvent railroads on acquisition of substantial trackage slated for

abandonment or for acquisition by public bodies because of inability to operate at a profit—a question we need not decide—we reject the GPs' arguments that it would have done so. In the first place, if the GPs wished to show that the ICC would not have permitted certain branch lines slated for abandonment to go out of rail use, they bore the burden of coming forward with reasonably specific evidence that the ICC would have insisted on adding particular lines or sets of lines to the Ts' proffers, see Second Pre-Trail Order ¶ 9(e), Sp. Ct. Rep. at N 11800. The GPs, however, have made no attempt to show that any particular nonproffered line would have been added. Nor did they attempt to show that any particular nonproffered line did not qualify for abandonment under the ICC's usual standards, even though their own witness stated that the ICC would have relied substantially on established abandonment criteria. Corber (S) (Jan. 31, 1979) at 42. Hence, as to lines slated for abandonment, the GPs' argument fails for want of proof.

Furthermore, we seriously doubt that the ICC would have conditioned acquisition of EL's main freight lines on the acquirer's conducting EL's passenger operations, regardless of pleas by New Jersey for it to do so. The relative bargaining strengths of solvent acquirers and the State would have been the same as they were in the negotiation phase. For the reasons discussed at pp. 207-09, *infra*, solvent acquirers almost certainly would have refused to undertake those carriers' passenger services on any terms, even to the point of preferring to let the Ts' freight lines go out of rail use. The solvent acquirers could credibly threaten to walk away from the entire transaction if the ICC imposed such a condition and the GPs recognize that the ICC could do nothing to stop them. 6 GP at W 41-42; see also ELRB at 270-71. The GPs suggest that the ICC in that circumstance could have required EL to operate a viable pared-down core system; but, passing the question whether the ICC could constitutionally have done so, the record contains no evidence that EL had any such viable core standing alone. Unable to sell

any part of its system with such a condition imposed and unable to operate it profitably, EL would have had a constitutional right to cease all its operations. See *CUE Opinion*, 439 F.Supp. at 1356-57, 1364. The GPs' own witnesses, however, testified that the ICC's "foremost objective" would have been to preserve needed rail service. Corber (S) (Jan. 31, 1979) at 19. Because there would have been no real doubt that EL's passenger operations would have been kept in service by public bodies in any event, and because a stubborn attempt to foist them onto solvent railroads could well have resulted in loss of the entire EL system for rail use, the ICC almost certainly would have refused to gamble.[203]

This reasoning does not apply to AA, since Michigan stood ready to buy the Toledo-Ann Arbor segment if a solvent bidder for that branch balked at a condition that it also acquire the lines north of Ann Arbor. But the only reason the GPs advance for supporting that the ICC would have conditioned the acquisition of one line on another is that the ICC "would have prevented the transferor from skimming the cream from their systems, while in allocating to public bodies the cost of operating other transferor lines essential to both the public interest and the very earnings claimed by the transferors". 6 GP at X 11. Passing the "public interest" clause, which the GPs do not expand upon, that reason does not apply to AA, for the earnings value of its Toledo-Ann Arbor segment does not depend on traffic from the northern line. See p. 280, *infra*. Such a condition would tend to drive the price AA could realize down to X. But the GPs' own evidence is that the ICC would not deliberately have sought to reduce prices paid to the Ts without a good reason. Corber (S) (Jan. 1980) at 24. Because the GPs do not suggest a reason, we find that the ICC would not have imposed such a condition.

Appendix H

(b) *Early ICC Approval of Particular Transferors' Sale and Abandonment Applications*

In our *CUE Opinion* we indicated our preliminary view that "[t]he solution which the ICC would have had to devise to the regional rail crisis would have involved a complex piece of regional planning, and we think it unlikely that the ICC would have tied its hands early in the proceeding by permitting abandonment or sale of major lines even before it knew what shape the surviving system might take." 439 F.Supp. at 1375. As we envisioned this regional planning process, the ICC would have recognized in advance the possibility or likelihood of interrelationships between the various Ts' sale and abandonment applications. It therefore would not have given individual applications detailed attention until all sale applications, or at least all of the major sale applications, were before it. All of the applications would have been consolidated and studied as a whole, and the ICC would not have permitted any single transaction to be consummated until it was ready to give its approval to all of them. Consolidation of the Ts' applications thus has an important effect on the time at which each could have completed its sales and abandonments.

No T except CNJ has gone so far as to argue that it would have reached agreement with a purchaser and received all necessary administrative approvals before it became clear that other Ts were also going to propose major sales and abandonments, and we reject that argument at pp. 305-09, *infra*. Nevertheless, several Ts take issue with our preliminary view in another way: they argue that they could have persuaded the ICC to approve part or all of their transactions before those of the other transferors—principally PC—even after the need for regional planning became evident.

The evidence is clear that the ICC would have entertained a strong presumption in favor of consolidation of all the Ts' applications. In its report rejecting the PC trustees' proposal to liquidate, the ICC emphasized the need for a "solution which deals

with Penn Central in the context of a territory-wide approach encompassing the other carriers serving the Northeast". *Penn Central Transportation Co. Reorganization,* 347 I.C.C. 45, 112 (1973). GP witnesses Robert Brooks, who was director of the ICC's Office of Proceedings at the time the Ts' applications would have been filed in the alternative scenario, and Robert Corber, who served as a Commissioner of the ICC from 1975 to 1976, both testified persuasively that they would have followed that course.[204]

None of this evidence focuses on the situations of particular Ts, but it places a very heavy burden on the Ts to demonstrate that it would have been an abuse of discretion for the ICC not to consider and approve a particular transaction before the others. That burden can be met only if, at a minimum, it is shown that, first, advance approval of the transaction would not have tied the ICC's hands with respect to other transactions in any important way, and second, the transaction would have been essentially unopposed. The first requirement, noted in the passage from the *CUE Opinion* quoted above, needs no explanation. The second is a consequence of the relatively short time limit we have assumed that Congress would have set on the ICC's deliberations. Before 1973, contested sale and abandonment transactions of any size rarely if ever received administrative approval in less than the twenty to twenty-four months we assume that the ICC would have had; the creditors of the Ts' estates could not reasonably have expected them to conclude sooner. Given its past record, any procedures used by the ICC that resolved large, contested sales and abandonments within this short a time would have been per se reasonable in our view. Only large transactions are in issue, however, for in accordance with the warning in our *CUE Opinion,* 439 F.Supp. at 1375 n.40, the Ts direct their early-approval arguments only to their entire systems or major portions thereof.

We conclude that none of the T's has met this burden. EL does not attempt to show that it could have escaped consolidation of its

case with PC's. None of the other T's has made the necessary showing that its disposition would have gone unopposed before the ICC. Abandonments would doubtless have been opposed by shippers on the relevant lines. See Hansen (S) (Nov. 1, 1979) at 7-8. Public bodies faced with having to acquire losing lines would likely have tried to persuade the ICC to include those lines in another system. See Stangl (S) (Nov. 1, 1979) at 17. And sales to solvents would have raised opposition from other solvents who had submitted competing bids, from solvents seeking traffic protection conditions, and from shippers seeking to condition the acquisition of profitable lines on acquiring lines slated for abandonment.[205]

Apart from the general question of opposition to their respective dispositions, each of the Ts remaining in the case (except EL) presents its own specific arguments for early disposition. We discuss and reject the arguments of CNJ in Part XIII, *infra*. Here we find that the arguments of LV and AA are also without merit.

LV argues that by June 1973 it was well on its way to cessation of its rail operations, and that the ICC would not have been likely to "stop LV in its tracks so that the other Transferors could catch up". LVRB at 17. LV also argues that because of its small size, its disposition would have posed few problems for the ICC. *Id.* Both arguments are apparently intended to apply only to LV's stand-alone case. See LV at 8. Although we have not discussed this case in detail, we think it founders for lack of identification of even one, let alone two, competitive bidders. If these contentions are meant to apply to an EL-LV acquisition, then they clearly lack merit. Neither LV's progress in its reorganization nor its size would have been relevant if its disposition were bound to EL's.[206]

AA argues that its small size and relative geographic isolation would have rendered it unnecessary for the ICC to include it in any regional planning process. AA at 36-39. As the GPs correctly point out, however, 2 GPRB at U 22-23, the argument that

AA's disposition would have preceded PC's is inconsistent with AA's own premise that the earnings value of the Toledo-Ann Arbor segment would have been established by the bidding of an acquirer of PC's IFLs. Moreover, AA has not demonstrated that its sale would have been unopposed. As AA strenuously argues, there would have been numerous bidders for its profitable Toledo-Ann Arbor segment. AA at 28. Any sale would thus likely have been opposed before the ICC by the unsuccessful bidders. The State of Michigan, faced with the prospect of acquiring AA's losing northern segment, would doubtless have tried to persuade the ICC to require the private purchaser of the Toledo-Ann Arbor segment to take the northern segment as well. As in the cases of the other Ts, the ICC would have taken the full reasonable time available to it to consider these objections.

(c) *Necessary Transactions Following Approval*

Conveyance of the Ts' properties in the alternative scenario would have been neither automatic nor immediate after ICC approval. Undoubtedly a few "tag ends" would remain to be tied up. Shannon (D) (May 24, 1979) at 575, El App. K at 187.[207] The GPs contend that the transactions could not have been completed until at least eight months after they were approved by the ICC. 6 GP at T 147. EL's witness, Shannon, on the other hand, testified that two months would have been sufficient.[208] Our review of the evidence and arguments indicates that Shannon's estimate is more nearly accurate.

The GPs' estimate of eight months rests on four assumptions, all of which we find flawed. First, the GPs contend that renegotiation resulting from conditions that the ICC would have imposed on the sales would have taken time. 6 GP at T 148. But we have already held that the ICC would have imposed no conditions of any significance. The GPs also argue that conveyance would have been delayed by petitions for reconsideration that opponents

of the transactions would have filed with the ICC. The Commission, however, would have placed a strict time limit on the filing of petitions for reconsideration and could have been expected, in line with the congressional policy, to decide them very promptly. The GPs' third argument, and perhaps its best, is that opponents of the approved transactions would have sought and obtained judicial review of the ICC's actions, and that this would have resulted in significant delays. 6 GP at T 50. There is evidence, however, that approval by reorganization courts would have been almost immediate.[209] It is likely that any reviewing court, faced with both a clear congressional policy reflected in the deadline imposed on the ICC and the possibility of massive shutdowns, would have moved most expeditiously. Indeed, as in the case of the Rail Act's provision that this court must decide appeals from the initial decisions of the reorganization courts within 80 days, § 207(b)(1), Congress could well have placed severe time limits on the taking and decision of appeals. The GPs' final argument, that arrangement of credit terms would have delayed the process, 6 GP at T 151, is also without merit. The needed financing could and would have been assured before the sales agreements were concluded.

C. *Conclusion*

Arriving at a precise date on which the Ts' properties would finally have been conveyed in the alternative scenario is now a matter of summarizing the conclusions we have reached and performing arithmetic. The process of disposing of rail properties would have begun in February 1973. Studies by acquirers of the properties and negotiations would have taken ten to twelve months, and ICC deliberations would have taken twenty to twenty-four months. Taking into account the possibility of judicial review, the properties would have been conveyed about April 1, 1976.

We recognize that in arriving at this date we have relied on crude estimates for each phase of the process. Our result necessarily reflects the roughness of its components; some of the periods may be too short, others too long. The conveyance of Ts' properties *might* have taken place somewhat earlier or somewhat later than April 1, 1976. But we are satisfied from the evidence that this is the most likely date, and that neither an earlier nor a later disposition is any more likely. In our *CUE Opinion* we held, tentatively, that conveyance would not have occurred before April 1, 1976. Today we reaffirm that holding, and hold further that it would have taken place no later.

XI. Acquisitions by Public Bodies

The JTTs allege that public bodies in New Jersey and Pennsylvania would have paid net salvage value to acquire their predominantly freight lines in the terminals areas and would have paid prices greater than net salvage value to purchase their predominantly passenger lines.[210] The GPs' assault on these contentions is multifaceted. The GPs categorically reject the notion that the JTTs could have erected a firewall between their allegedly profitable main freight lines in the west and the losing public body lines in the east. In the GPs' view, public bodies would not have paid some $265.5 million for the predominantly freight lines within the JTs,[211] and another $265.1 million for the predominantly passenger lines,[212] when the continued operation of these lines was essential to the JTTs' realization of earnings values from the sale of the main freight lines. Moreover, the GPs allege that the acquisitions envisioned by the JTTs would have imposed an additional operating burden on the public bodies of $250 million annually.[213] In light of the difficulties faced by states in the Northeast in the mid-1970's, the assumption of such staggering costs would have been unlikely. Rather, public bodies would have used every means at their disposal to keep ownership of the "public body" lines in private hands. This would have involved attempts, including offers of financial subsidies if necessary, to induce the potential purchasers of the JTTs' main freight lines to

In addition to these factual contentions, the GPs present a number of legal arguments against awarding values to the Ts based on hypothetical sales to public bodies.[214] First, the GPs maintain that the Ts' claims impermissibly assume changes in state law that were not reasonably foreseeable in February 1973. Second, they allege that the Ts mistakenly based certain of their claims on actions by the federal government that would have amounted to alternative, long-term federal responses to the rail crisis. Third, the GPs argue that federal condemnation law forbids compensating the Ts for the value to the public or social value of their properties. Fourth, the GPs contend that the Ts' cases offend the Supremacy Clause by relying in several respects on limitations on state power that do not bind the federal government.

As a threshold question, the GPs hotly contested the JTTs' classification of terminal area lines into "predominantly freight" and "predominantly passenger" segments. In classifying their lines, the JTTs followed a rule of thumb dubbed somewhat derisively the "six-train rule" by the GPs. As described by the JTTs' witness:

> A line was deemed to be predominantly passenger if it was used for (i) six or more round trips per day of passenger trains regardless of freight density; or (ii) some passenger trains but less than six round trips per day of freight operation. All other lines were considered to be predominantly freight lines.

Storm (S) (JT) (Dec. 15, 1978) at 7 n.1.

In their briefs the GPs attack the six-train rule as designed to result in the smallest possible amount of trackage being designated predominantly freight. The JTTs' classification yielded a system in which, with few exceptions, every segment that carried any passenger traffic was designated a passenger line even though virtually all of these also carried some freight traffic, and some carried substantial amounts of freight traffic. Lines designated

as predominantly freight were almost without exception those dedicated exclusively to freight service. See Tomlinson (S) (JT) (Dec. 1, 1978) at 12-13. Moreover, the GPs argue, the predominantly freight lines do not form a contiguous system.

According to the GPs, the minimization of the predominantly freight trackage benefits the JTTs' case in three ways. First, because the JTTs allege that predominantly freight lines would have been acquired at net salvage value, while passenger lines would have brought a premium in excess of net salvage value, maximizing the passenger trackage would yield greater sales proceeds to the JTTs. Second, regardless of any passenger premiums, if the predominantly freight lines were included in the sales of the main freight lines to solvent railroads at no extra cost, while the predominantly passenger lines were sold to public bodies for net salvage value, maximizing the number of passenger lines would similarly increase the total proceeds from these sales. Third, reducing the number of predominantly freight lines minimizes the switching costs that the JTs would have charged back to the connecting line-haul carriers, thus inflating the earnings values of the main freight lines.

We resolve the dispute over designation of lines by accepting most of the contentions of both sides. We agree with the JTTs that the existence of important commuter service distinguishes the predominantly passenger lines because only the public would have provided the necessary funding to keep the passenger operations running. See pp. 207-11, *infra*. The GPs' objections center upon the enhancement of value of the JTTs' lines as a whole that results from the JTTs' designations. As the GPs' counsel put it at oral argument, "it doesn't matter whether you call something a passenger line or a freight line, or you call it a rail line, or you call it a tangerine. The important point is the way that you allocate costs." Tr. at 303. We accept the GPs' objections in determining the prices that public bodies would have paid for the predominantly passenger lines, see pp. 231-44, *infra*, and the trackage rights fees public bodies would have charged for

use of the passenger lines for freight movements, see pp. 244-51, *infra*. The GPs' arguments we accept as to the passenger lines are largely the same as those we accept as to the predominantly freight lines in the terminal areas. The analysis of these freight lines is more straightforward in that there is no need to consider complications introduced by the presence of passenger traffic on the same lines. Thus we begin our examination of the prospects for public acquisition by considering the JTTs' case for creation of public joint freight terminals.

A. *The Joint Freight Terminals Case*

Despite the great expense and the extensive studies the JTTs undertook in formulating the JTs case, their argument that public bodies would have acquired the terminal freight lines and set up JT companies is surprisingly weak. The JTTs do not claim that it would have been necessary for public bodies to have purchased the predominantly freight lines as a last resort, stepping in reluctantly to avert the disaster that cessation of freight service in the terminals areas would bring. On the contrary, the JTTs maintain that private purchasers of the main freight lines would have been willing to acquire the predominantly freight lines in the terminal areas as well had the public bodies declined to venture into the freight business. See 1 ELF at 57-59 (EL-LV); 1 RF at 192-213. The JTTs' position is that, having solved their most vexing problem by acquiring the predominantly passenger lines, public bodies would have forged ahead and purchased the predominantly freight lines in order to create the JTs. The primary purpose of the public bodies in undertaking these projects would have been to promote industrial development by eliminating duplicative facilities and providing more efficient service to connecting carriers and local users. Combined ownership of the freight and passenger lines in the terminal areas would also have allowed better coordination of the two types of traffic, including reduced interference between freight and passenger trains and

insured equality of access to freight service by industries in the area. Public purchase of all the Ts' terminal properties would have been more likely than piecemeal acquisitions by individual solvent railroads, since the acquiring roads would not have been able to achieve the economies made possible by a unified public acquisition and also would have been unwilling to risk being saddled with responsibility for passenger operations. See Hesse (S)(JT) (Dec. 15, 1979) at 29-30.

There is a fundamental problem with the JTTs' argument. While the central purpose of the JTs was to eliminate duplicative facilities and services and to cut switching costs, the JTTs presented no evidence to show that the JTs' switching charges were lower then the switching costs that would have been encountered by prospective purchasers of their main freight lines in the absence of the JTs. In fact, evidently concerned that the GPs' assault on the JTs case might prove successful, the individual JTTs alleged alternative outcomes in which switching costs on their lines would have been lower and earnings values correspondingly higher without the "benefit" of the alleged economies achieved by establishment of the JT. See Statement of EL Trustees in Response to the Court's May 21, 1981 Memorandum (June 1, 1981) at 8-9, Sp. Ct. Rep. at N 35818-19; ELRB at 124-28; 1 RF at 192-213. EL suggested at oral argument that the NJ/NYTerms' switching charge might have been advantageous to purchasers of the lines of some of the Ts, such as PC, but not to purchasers of others, such as EL or EL-LV. See Tr. at 54-55. And the fact that the JTTs themselves never even attempted to form a JT in the real world suggests that the prospects for effecting major savings while preserving the status quo of traffic distribution had never been thought very good.

Beyond this, we do not think that a solvent railroad interested in buying a T's main freight line would have been reluctant to purchase the T's predominantly freight lines as well. These were not segments that the solvents could afford to ignore.[215] Without the continued operation of the terminal lines, the sales of the main

freight lines would not have been possible. See Hesse (D) (May 2, 1979) at 132, 11 GP Supp. App. at 180. The inability of individual purchasers to achieve the economies alleged to be possible in a JT would at best have affected only the price a solvent railroad would have been willing to pay for the package and not its willingness to buy. Indeed, prospective purchasers of EL and LV would have had reason to regard the creation of the JTs with some apprehension. Unlike publicly owned terminal railroads in other cities, which are rather local in extent, the terminals proposed by the JTTs cover vast areas.[216] In New Jersey, for example, the terminal includes LV's main line, spanning 76 miles from Jersey City in the east to Phillipsburg in the west, R's line running 27 miles from West Trenton north to Bound Brook, and 42 miles of the old Lackawanna line from Dover to Phillipsburg, much of which lies in areas of the State far from the New York port and which no one, prior to this litigation, ever would have conceived of as forming part of a terminal railroad. We are also incredulous that a Western purchaser bent on creating a transcontinental system would have been content to stop at the western border of New Jersey, leaving control of its entry to New York in the hands of a public agency that lacked any experience in freight service.

A purchaser's apprehension at this state of affairs would only have been increased by the ambitious design of the JTs experiment. Even if we were to assume that the public bodies would have followed the JTTs' detailed operating plans and costing decisions to the last letter, purchasers of the main freight lines would have had to consider the significant risk that savings achieved on paper would not have been realized in the yards. A prospective purchaser of the main freight lines would thus have to reckon with a host of unknowns, including the possibility that a public terminal's switching charge might have exceeded the costs the purchaser would incur by acquiring and operating the predominantly freight lines itself, or that existing traffic patterns in the terminal area would be disturbed to its detriment.

Moreover, it is somewhat incongruous for the JTTs to argue that Western railroads would have engaged in competitive bidding to acquire their main freight lines to the east in order to protect or promote their position but would have declined to compete in the terminals area where much of the traffic they desired originated. Even if a purchaser were agreeable to the creation of a JT, it would have had cause to fear that an aggressive competitor acquiring another main line would have insisted on purchasing some of the predominantly freight lines for itself in order to gain a competitive edge. For all these reasons, solvent railroads looking to acquire the main freight lines probably would have taken a cautious attitude towards the establishment of publicly owned JTs.

None of this is to suggest that if the public bodies had insisted on acquiring the JTs properties, purchasers of the main freight lines would have absolutely refused to cooperate. We doubt, however, that public bodies would have been particularly interested. The chief reason cited by the JTTs why public bodies would have sought to acquire the JT lines is their desire to take advantage of the unique opportunity provided by the rail crisis to rationalize and upgrade terminal facilities and services, thereby improving the climate for industrial development. As evidence of this, the JTTs cite several studies and reports recognizing the need for consolidation and modernization of rail facilities in the New York and Philadelphia port areas, see JT at 29-30 & n.19, a need which the GPs do not dispute. The JTTs, however, have not provided any credible evidence that New Jersey and Pennsylvania would have volunteered to undertake these grand projects in the circumstances of the alternative scenario. By contrast, the GPs rely on a bevy of public transportation officials who uniformly testified that public bodies had virtually no history of involvement in freight service,[217] that freight service had long been regarded as the responsibility of the private sector, and that acquisition would have been considered only if the alternative was abandonment of essential freight lines. See Altshuler (S) (Nov. 1, 1979) at 23;

Simon (D) (Apr. 20, 1979) at 47, 20 GP Supp. App. at 50; Stangl (S) (Nov. 1, 1979) at 20-21; Stangl (D) (Mar. 19, 1980) at 198-99, 256, 19 GP Supp. App. at 728-30; Tennyson (D) (Mar. 19, 1980) at 38-39, 43-45, 20 GP Supp. App. at 714-18; Whitehurst (S) (Jan. 30, 1980) at 46-49. In the words of one New Jersey official, in 1974

> the state was concerned about the possibility of being required to take a more direct role in the passenger business and the last thing we wanted to do or, in fact, were prepared to do, was get into the rail freight business.

Stangl (S) (Nov. 1, 1979) at 20.

Moreover, as developed below in our discussion of the financial feasibility of public acquisitions, public bodies' efforts to come up with the funds necessary to acquire and operate the passenger lines would hardly have been painless. While we do not say that they would have been unable in addition to finance a purchase of the predominantly freight lines if this were necessary to preserve freight traffic, it is rather plain that public bodies would not have been willing to spend the amounts sought by the JTTs solely to attain new heights of freight service. The only immediate beneficiaries of such largesse would have been the bankrupts, which would have raised their asking prices for the main freight lines to the extent that the costs of terminal services were reduced and also would have realized additional amounts from the separate sales of the terminal lines to public bodies. The public benefits of more efficient terminal services, if realized at all, would doubtless have taken years to emerge.

This leaves only the argument that combined public ownership of the freight and passenger lines would have had the advantage of increased possibilities of coordination of rail service. Contrary to the JTTs' view, public bodies would have had no need to acquire the terminal lines to reduce interference between freight and passenger trains, since virtually all of this would have

occurred on the passenger lines they are already presumed to control. Insuring equal access to freight service is hardly a sufficient incentive to justify an investment of hundreds of millions of dollars. We conclude that public bodies would have resisted buying the predominantly freight lines and that these would have been acquired instead by the purchasers of the main freight lines.[218] We thus do not reach the complex issue of the reasonableness of the switching charge computed by the JTTs.

B. *Predominantly Passenger Lines in Northern New Jersey*

We find that EL's passenger lines in the North Jersey area would have been publicly acquired in the absence of the Rail Act.[219] In reaching that conclusion, we consider the strength of public bodies' motivation in the alternative scenario and their legal and financial capacity to consummate the acquisitions. After resolving the likely disposition, we face the more complex questions of what price would have been paid for EL's passenger lines and what trackage rights fees would have been charged for freight movements over the publicly acquired passenger lines.

1. *Legal Capacity*

As a threshold question the GPs contend that, since none of the states involved possessed the legal authority to acquire railroads and the requisite changes in the law were unforeseeable, acquisition by public bodies may not be considered in determining the value of the Ts' property.[220] The legal rule cited by the GPs is applied when a condemnee's valuation is premised upon a hypothesized private purchaser that would have put the property to a new use forbidden by law. But, for example,

> [w]here . . . there is a possibility or probability that the zoning restriction may in the near future be repealed or amended so as to permit the use in question, such likelihood may be considered if [and to the extent that] the prospect of such repeal or amendment is sufficiently likely as to have an appreciable influence upon present market value.

4 Nichols, Eminent Domain § 12.322[1] (3d ed. 1979) (footnote with citations omitted). In this case, however, the potential buyer is the very body that makes the law. The absence of preexisting authority cannot, therefore, be said to diminish the prospect of public acquisition since a state's decision to purchase portions of the Ts' railroads would be embodied in legislative or constitutional enactments providing the necessary authority.[221] Since we reject out of hand the applicability to this case of the legal principle cited by the GPs, we will forego examination of various Ts' responses to the factual predicate of this argument. Thus, the only two relevant questions are the ones we turn to next: whether New Jersey would have been sufficiently motivated to acquire the Ts' passenger operations in the absence of the Rail Act[222] and whether New Jersey would have had the financial capacity to complete the transaction.

2. *Public Acquisition*

The GPs' further response to the Ts' passenger cases is a variant of their general argument that, so long as substantial profits were projected on the main freight lines, public bodies would have refused to buy any lines on which those profits were dependent. Just as public bodies would have opposed the erection of an artificial firewall between the main freight lines and the predominantly freight lines in the JTs, so would they have resisted the establishment of an "inner" firewall between privately owned, profitable freight lines and publicly owned, losing passenger lines. Rather than acquiesce in such "cream-skimming", public bodies would have sought to persuade the private purchasers of the Ts' main freight lines to buy and operate the passenger properties as well. If necessary, public bodies would have offered to raise their passenger service subsides above the avoidable cost level. If that effort failed, states would have proceeded to petition the ICC to condition approval of a sale of the main freight lines on inclusion of Ts' passenger properties. See pp. 188-91, *supra*. If all these

efforts proved unsuccessful, public bodies would have been forced by lack of funds and the political infeasibility of increased spending for public transportation to acquiesce in the abandonment of the passenger lines. Given the alternatives of increased bus and automotive transportation, the consequences of a shutdown of rail passenger service would not have been so catastrophic as to foreclose it as an option. Finally, the GPs contend that even if public bodies did agree to buy some of the Ts' passenger lines, they would not have agreed to buy them all. We shall address each of these contentions in some detail. In this subsection we consider how strong New Jersey's interest in acquiring EL's passenger lines would have been in the absence of the Rail Act.

EL stands on rather firm ground with respect to public acquisition of its passenger lines. EL emphasizes that no solvent railroad contemplating a purchase of its main freight lines or of the EL-LV package would have been willing, or could have been forced, to go through with the deal if responsibility for the passenger service was included, see Shannon (S) (EL) (Dec. 31, 1978) at 91, because passenger service had been a losing proposition for many years and a substantial drain on the bankrupts providing it. Although public bodies were heavily involved in subsidizing passenger service, they had insisted on paying no more, and in some cases less, than the avoidable costs of passenger operations.[223] Under this approach, common costs such as track maintenance were allocated to the "base" or freight service. See Whitehurst (S) (Jan. 30, 1980) at 7. EL's witness Shannon bluntly stated:

> [R]unning passenger service is a pain. It's politically oriented. I've been in the passenger business for almost 25 years and ran suburban service and nobody in their right mind will buy it, except the public.

Shannon (D) (May 23, 1979) at 389-90, ELP App. at 79-80.

When pressed, Shannon did state that a private purchaser theoretically would have been willing to assume responsibility for

conducting passenger operations if guaranteed 100 percent subsidization of operating deficits plus a fair return on investment. He thought that under those conditions it would have been cheaper for the State to buy and operate the passenger service itself. Shannon (D) (May 23, 1979) at 381-86, ELP App. 87-93. That seems most unlikely since, even if operating costs would have been lower under public ownership, the public would have saved the full acquisition price if it could have succeeded in having the lines included in the sales of the main freight lines without affecting the price in the private sale. But there are other reasons to believe that the passenger lines would have been disposed of differently from the freight lines. Potential acquirers of the freight lines would have been reluctant to become involved in passenger service even indirectly, for there was no likelihood that any public body would make, or could persuasively claim to make, a guarantee of 100 percent subsidization for the indefinite future. Further, since the demands of scheduling passenger service are greater than those for freight, a public body would have seen some advantage in owning the passenger lines so as to minimize scheduling conflicts. Finally, if New Jersey had not been willing to purchase EL's passenger lines, at least some of them would have been abandoned since they would net more to EL as scrap than if they were included in a freight package.

This is not to deny that New Jersey would have been reluctant to purchase and operate the passenger lines or that the State would have attempted instead to persuade the solvent railroads to accommodate it. It is simply to say that the State's arguments in this regard would have lacked force. The weakness of the State's position is reflected in the evidence on this point. While the GPs produced several witnesses who testified that public bodies would have tried to negotiate a private purchase of the passenger lines, one was willing to say that such efforts would have been likely to achieve their goal. By contrast, EL's witnesses emphatically denied that any solvent railroad could have been persuaded to

enter the passenger business. This testimony went without significant contradiction, and is corroborated to some extent by the fact that in connection with the FSP proposal that Chessie buy EL and R, "it became clear that as a condition of purchasing these properties, Chessie did not want to assume the obligation of negotiations with the commuter authorities." 1 FSP at 46 n.5. As a result, USRA recommended that Chessie not acquire any passenger lines but rather obtain trackage rights over them for freight service. *Id.* at 232-33.

We think that New Jersey, unlike a private acquirer, would have been willing to purchase EL's passenger lines. These lines, including about 165 miles running through some of Northern New Jersey's most heavily populated bedroom communities, see EL Map 1, carried more than 35,000 passengers in each direction on an average weekday. The lines ran to Hoboken and Newark, and connected to the PATH rapid transit system to Manhattan at Hoboken. New Jersey had demonstrated its financial commitment to EL's passenger service over the years in the form of operating assistance payments, capital improvements, and various kinds of tax relief. The size of these operating assistance payments had been rising dramatically in the 1970's—$5.2 million in 1970, $9.1 million in 1973, and $17.9 million in 1975. See Ex. ELR-NJ-1 at 3, ELP App. at 16. While some of the publicly financed capital improvements had been paid for by federal as well as State funds, others were shouldered exclusively by the State, as evidenced by the purchase between 1967 and 1972 of 155 passenger cars and 32 locomotives at an approximate cost of $41 million.[224] See Ex. PCT-NJ-48 at A 17, ELP App. at 23. We find it hard to believe that New Jersey could have seriously contemplated abandonment of the State's passenger lines. See Ex. PCT-NJ-13 at 1-2 (Transportation Commissioner Kohl) ("40 lanes of expressways would be necessary to provide equivalent travel during rush hours," which would entail "huge cost [and] would be socially and environmentally unacceptable"); Ex. PCT-NJ-114 at 5-7 (Commissioner Kohl)

(infeasibility of transferring rail commuters to buses and automobiles); Ex. ELR-NJ-6 vii (New Jersey Commission on State Tax Policy) ("great public cost, if not impossibility, of providing equivalent highway transportation facilities").

Apart from the State's need to purchase its lines to keep the passenger trains running, New Jersey would have some affirmative motivation to make the acquisition in order to achieve the financial and operational control that comes with ownership. This advantage was becoming increasingly clear to State transportation officials during the 1970's as the cost of subsidizing private carriers rose while service declined, and was in fact cited by the State in 1978 when it acquired the major portion of EL's passenger lines. See ELP at 19-27. Unless the State took this next logical step to ownership, it would have had to face the prospect of continuing to sink huge sums into capital improvements and to pay out ever larger subsidies to an entity which had no incentive to improve service or achieve economies and over which the State had no legal control.

In all, EL's commuter service was too important to the State for abandonment to be considered a realistic option. New Jersey could not have convinced solvent railroads or EL to include losing passenger lines in the sale along with EL's freight lines. Under these circumstances, New Jersey would have had no choice but to acquire EL's passenger lines. The Ts' cases for public acquisition of their predominantly passenger lines are not immune, however, from our criticisms of the JT case since these lines did carry freight traffic. But arguments that were decisive against public acquisition in the case of the terminal freight lines have an impact in the case of the passenger lines limited to the prices public bodies would have paid and the trackage rights fees they would have charged.

Appendix H

3. *Financial Capacity*

The GPs allege a second barrier to New Jersey's purchase of EL's passenger lines for continued rail use: the inability of the State to finance the acquisition.[225] Most of their analysis, however, purports to be offered in support of the more limited proposition that "the financial constraints on public bodies would have reinforced their determination to pay no more than the minimum for any lines".[226] We find this latter proposition persuasive; in fact, it was conceded by EL's only witness on the issue of New Jersey's financial capacity. Cahill (S) (EL) (Oct. 15, 1980) at 10. But the GPs' broader contention fails. Their reply brief properly identifies the question. After conceding that virtually no single undertaking would be impossible financially, it states "the financial ability issue . . . cannot realistically be divorced from the practical ability and political willingness of public bodies to cut existing programs and impose new taxes", 2 GPRB at K 17. Yet the GPs' argument fails to meet this issue, since it analyzes the alleged historic unwillingness of New Jersey to commit massive funding to public transportation projects as though the rail crisis would have had no impact upon its financial decisions.

Examination of New Jersey's financial capacity must begin with reference to the cost of taking over the passenger lines. Based upon the Ts' allegations, the GPs indicate that the total acquisition cost for all of the proffered public body lines in New Jersey would have been approximately $518 million.[227] 4 GP at P 132 (Chart P-1: "New Jersey as Fairy Godmother"). From this must be subtracted the costs of the JT freight properties, leaving a total of some $363 million—a figure including $109 million for the Northeast Corridor Spine and $100 million claimed by CNJ for its freight and passenger lines. This figure is an upper limit since it assumes that the Ts will prevail on all their contentions relating to prices that public bodies would have paid. Since we reject EL's claim for a premium above X, see pp. 218-31, *infra*,

and accept the GPs' argument for deductions from X, see pp. 231-44, *infra*, it is evident that the $363 million figure substantially overstates the actual financial requirement. And to the extent that any of the GPs' claims in the nonrail use phase of the case prevail, the burden would have been even less.

An additional financial burden would have resulted from the State's assumption of all operating costs of the proffered lines.[228] The GPs' estimates place the annual burden, above preexisting commuter subsidies, which amounted to $30 million in 1974, at nearly $110 million. 4 GP at P 135. For purposes of determining the State's ability to finance the takeover of passenger lines, the figures are overstated in that nearly half of the alleged increase is to cover the cost of freight operations in the NJ/NYTerm. See Aaron (S) (Jan. 30, 1980) App. J at Table 2. Thus the $30 million subsidy already being expended in 1974 was a substantial fraction of the alleged total, and, because the subsidy had been increasing, see p. 210, *supra*, the amount by which the total burden would have exceeded subsidy levels absent public acquisition would have been even less in future years.[229]

The GPs also present evidence from First Boston indicating the hypothesized increases in New Jersey's sales, corporate income, and motor fuels taxes that would have been necessary to finance $114 million in annual operating burdens in an attempt to put their operating cost estimates in perspective. First Boston's figures, present a somewhat distorted figure because they are based on the assumption that only one revenue source would shoulder the full burden, First Boston (S) (Jan. 30, 1980) at 42, giving an impression that in effect triple-counts the total cost.[230] Their budget figures, *id.* at 44-45, repeat this illusion by implicitly assuming that the entire burden would be met by budget cuts concentrated in a single area.[231] If, more realistically, this burden were spread among tax increases and budget cuts in several areas, it seems clear that the burden would be bearable in light of the public necessity.

The GPs correctly note that the mid-1970's were a time of tight money, when numerous demands competed for limited State funds. 4 GP at P 69-87; 2 GPRB at K 31 & n.48. The GPs argue, for example, that New Jersey's historically low government expenditures reinforce the conclusion that the State would have been inclined to spend as little as possible. 4 GP at P 145 (indicating, for example, that New Jersey ranked 49th among the states in per capita government expenditures per dollar of disposable income). But this also cuts the other way, because, if necessary, New Jersey was more capable of assuming an additional financial burden than were most other states. See Kaden (D) (July 22, 1980) at 241-42, ELP App. at 234-35 ("By comparison [to] New York, . . . New Jersey has today almost an infinite amount of fiscal capacity"). We also discount as self-serving some rather extreme statements indicating lack of financial ability made by state officials before Congress while it was considering rail legislation, see 4 GP at P 77-79. We agree with the GPs that "public bodies would have had the strongest possible economic motivation to adopt strategies to minimize any new financial commitment to rail transportation, and to pay the absolute minimum for any properties they did buy", *id.* at 79, so attempts by state officials to convince Congress to shoulder the burden were to be expected. But we are not convinced that permitting abandonment of the passenger lines would have been part of such a strategy.

EL identified several sources of funds available to New Jersey. Debt finance would appear to be one of the more likely. The GPs note that all three major transportation bond issues proposed in New Jersey in the 1970's were defeated at the polls, 4 GP at P 149, including a 1974 proposal for $100 million for the preservation of rail lines that might have been excluded from Conrail or, if the Rail Act was declared unconstitutional, for other lines that might have been abandoned by the bankrupts. Here the GPs are

on weak footing. That proposal failed by less than a three percent margin.[232] EL argues that defeat may well have been due to a failure to explain the proposal, the credibility gap created by the continuing failure of the State transportation department to spend public transportation proceeds remaining from a 1968 transportation bond issue, and guilt by association with the accompanying $200 million highway construction bond program that was defeated by a substantial margin. ELP at 47 n.41; Cahill (S) (Oct. 15, 1980) at 8. In addition, in the absence of the Rail Act the prospect of abandonment of these lines would have appeared a far more realistic possibility than it did at the time of the actual 1974 bond proposal. The GPs' primary response is to note that the legislative findings made at the time of this bond issue were similar to those EL hypothesizes would have been made in the absence of the Rail Act. 4 GP at P 149 & n.60; 2 GPRB at K 34. This point is nonresponsive to some of EL's allegations and is simply unpersuasive on the facts. The existence of a "whereas" clause in the legislative act referring to loss of essential services, especially when coupled with references to federal support under the Rail Act, is simply no substitute for the facts as they would have been perceived by the public in the absence of the Rail Act, when abandonment of the spine, EL commuter lines, and additional properties otherwise would have been imminent.[233]

Much of the GP's attack on other suggested revenue sources is based upon the conclusions of First Boston relating to the impact of financing acquisition with general obligations bonds. EL claims that First Boston considered a narrow range of alternatives, whereas in another study First Boston had noted the existence of many more. ELP at 32 & N.27. The GPs reply that general obligation bonds were the focus of the inquiry because they have the minimum impact of any funding source—which they claim was one of the conclusions of First Boston's earlier study that had considered other options, 2 GPRB at K 21-22. Although persuasive, this cannot substitute for a more detailed

investigation of alternatives. One might well conclude that general obligation bonds would have been the State's first choice. But that does not rule out all other possibilities in the event that New Jersey deemed it wise to spread the cost of the acquisition among a variety of funding mechanisms.[234]

EL also alleges that some funds could have been diverted from approximately $100 million that remained unspent from the previously noted 1968 transportation bond issue. The GPs' first reply is that "it would have made no sense" to have used the funds in this manner because nothing would have remained to make improvements that had been promised to voters for years. 2 GPRB at K 35; see also 6 GP at U 64-65. This is a "patently ridiculous" reply, since as EL points out, if the lines were not purchased there would have been no railroads left to improve. ELP at 45-46. Of course, the funds were needed for buses as well, 2 GPRB at K 37, and some were eventually spent there, Cahill (S) (Oct. 15, 1980) at 7, but in the absence of the Rail Act it seems likely that funds originally intended for rail improvement would have been available if necessary to finance rail passenger acquisition rather than being fully diverted to finance the acquisition of new buses.

It might appear that no income tax revenue would have been available to finance the purchase of the passenger lines, given that it took a number of years for New Jersey to enact its state income tax in response to the added financial requirements for the state school system after *Robinson* v. *Cahill*, 62 N.J. 473, 303 A.2d 273, *reargued*, 63 N.J. 196, 306 A.2d 65, *cert. denied*, 414 U.S. 976 (1973); see 4 GP at P 145-46. Yet former Governor Cahill's remarks, Cahill (S) (Oct. 15, 1980) at 6, that there was no real crisis in the interim years and that the income tax did pass shortly after the court ordered the schools closed in the summer of 1976 seem quite persuasive. The question here is only whether the state income tax would have been available to help avert a crisis in the absence of the Rail Act, and again there is reason to believe that it would. *Id.* at 6-7.

EL also makes reference to legislation introduced in 1973 to consolidate the State's toll roads, under which revenues made available from increased tolls could supposedly have financed between $550 and $800 million in new bonds. ELP at 39-43. EL asserts that this specific proposals is one way that acquisition could be financed with less credit impact than general obligation debt. *Id.* at 42 n.39. The GPs respond that this was one of many pieces of transportation legislation not enacted at the time and that the legislation eventually enacted in 1979 did not link this revenue source to the acquisition of transportation facilities. 2 GPRB at K 30 & n.47. Of course, in 1979 the State did not face the rail crisis it might have faced years earlier in the absence of the Rail Act. The GPs are more persuasive in noting that the toll consolidation proposal "is just another way to raise taxes", 2 GPRB at K 31, although it is not necessarily the case that opposition to increased tolls would have been as strong as that to imposing the State's new income tax at a higher level to cover the costs of acquiring rail lines.[235]

A final major funding source relied upon by EL is the use of federal funds, including the application of funds from the Urban Mass Transportation Act (UMTA), Federal-Aid Highway Act (FAHA) and, in particular, the Federal Aid-Urban System program (FAUS) under the FAHA, and revenue sharing. As a threshold argument, the GPs contend that consideration of this option amounts to allowing the Ts to benefit impermissibly from an alternative long-term federal response to the rail crisis. We reject the GPs' objection because the federal funds at issue are not part of a federal response directed at the rail crisis. These programs were all in place prior to the Rail Act. Furthermore, the scope of each program extends far beyond rail services formerly conducted by private railroads. If EL depended upon increased funding of these programs resulting from the rail crisis we would reject their claim, but we do not understand it to rely upon any such increases. The GPs also would have us reject this

option because of the need for project approval by federal officials. 1 GPRB at B 23 n.28. Yet such approval, to the extent it is consistent with preexisting legislative mandates, cannot be cast aside as an alternative federal response any more than various actions of the ICC and Congress posited by the GPs both in this[236] and earlier[237] phases of the case can be.

EL offered evidence indicating that New Jersey would have access to $400 million in UMTA funds and that there were $80 million of unobligated FAUS monies, the latter amount increasing at a rate of $50 million annually. ELP at 55-56. While acquisition of existing properties was accorded a low priority under UMTA policy, in the context of possible abandonments those priorities probably would have changed dramatically. This is not to deny that the limited federal money was substantially less than New Jersey's transportation funding needs at the time. See, *e.g.*, Kaden (D) (July 23, 1980) Ex. 39 at 6. Moreover, as the GPs note, because these would not be a new source of funds, their use would be viewed by the legislature as similar to using other State revenues. 2 GPRB at K 27-28; see Tennyson (D) (March 19, 1980) at 116, 31 GP Supp. App. at 677. The difficulty in using funds from the highway acts to finance acquisition of rail lines, see 2 GPRB at K 25-26 & nn.37-38, supports essentially the same proposition. But once again the GPs have failed on the ultimate issue. All the Ts need to establish as to federal funding sources is that in the absence of the Rail Act the State could have marshalled sufficient resources to meet what would have been one of its highest priorities. The availability of federal funds undoubtedly would have assisted New Jersey in purchasing the Ts' properties.

The only significant uncertainty is which sources in fact would have financed New Jersey's takeover of the passenger lines in the absence of the Rail Act. That is an issue we need not decide. There can be little question that New Jersey would have taken the concededly difficult and painful course of sacrificing some

expenditures on other programs and increasing the overall financial burden on its citizens to prevent the rail crisis from becoming even more unpleasant.

4. *Pricing*

We find that the prices public bodies would have been willing to pay in the alternative scenario would have been negotiated with reference to the value of EL's next best alternative. The GPs devote substantial efforts to establishing this pricing principle, see, *e.g.*, 4 GP at P 7-10, 66-242, and note that it was endorsed as the likely course by testifying public officials from all the affected states, 4 GP at P 10-11; 2 GPRB at K 10-13; Cahill (S) (Oct. 15, 1980) at 10, evidence that is most probative since the relevance of pricing theories is dependent upon the extent to which "particular prospective buyers would in fact have given weight to them", *CMV Opinion*, 445 F.Supp, at 1047. But the dispute for the most part is not so much over the principle itself as over its application to the alternative scenario, see, *e.g.*, ELRB at 287-88. For the passenger lines, the Ts concede that the next best alternative would have been liquidating the property for nonrail use. Thus, most pricing arguments begin with a base price of X, and argue for premiums and deductions from this as yet undetermined figure on the basis of the value of the hypothesized sales to and the relative bargaining positions of the Ts and the public bodies.

(a) *Erie Lackawanna's Claim for a Premium in Excess of X*

EL suggests that New Jersey would have paid in excess of X in order to avoid having to condemn EL's lines. One proffered motivation is that New Jersey would have sought to avoid the litigation costs incident to condemnation proceedings. This argument ignores what EL's own witness admits: similar costs would have been entailed for the condemnee. Shannon (D) (May 23, 1979) at 472-73, 18 GP Supp. App. at 270-71; Netzer (S) (Nov. 1, 1979) at 33-34. As a result, this consideration has

a neutral effect in that it gives both parties the same incentive to avoid condemnation.

Altogether different is EL's conjecture that New Jersey would fear a condemnation award in excess of X. Specifically, EL argues that a New Jersey court would award not merely salvage value for its passenger lines—approximately $104 million according to EL—but an additional "premium" consisting of $4.9 million for going concern value[238] and $5.7 million for the difference between gross and net liquidation value as well, Shannon (S) (EL) (Dec. 31, 1978) at 92—or, at least, that New Jersey would have had sufficient fear of this that it would have paid the relatively modest premium claimed by EL.

We see no basis for thinking that New Jersey would have feared an award based on gross liquidation value. Shannon conceded he knew of no case awarding both "gross liquidation value plus a going concern value premium." Shannon (D) (May 24, 1979) at 606-07, 18 GP Supp. App. at 284-85. In fact, we have been unable to discern the reasoning upon which EL and Shannon rely for the portion of EL's claim for the excess of gross over net liquidation value. If the argument is, as we suppose it to be—that since the condemnor would not dismantle, the cost of dismantling should not be taken into account—it runs afoul of the principle that the condemnor need pay only the condemnee's next best alternative, to wit, dismantling with its attendant costs.

EL's claim for a premium based upon the going concern value of its passenger lines is based upon two New York precedents, *In re Port Authority Trans-Hudson Corp. (PATH)*, 20 N.Y.2d 457 (1967), *cert. denied*, 390 U.S. 1002 (1968), and *In re Fifth Avenue Coach Lines, Inc.*, 18 N.Y.2d 212 (1966), *appeal dismissed*, 386 U.S. 778 (1967). *Fifth Avenue Coach* is readily distinguishable since, there, going concern value was awarded because the appellate court found that only the condemnor's stringent rate regulation had prevented the condemnee from operating at a profit. No such circumstances are present here. By contrast, *PATH* permitted augmentation of the award based

upon going concern value in the case of an unambiguously unprofitable enterprise, although the basis for the court's generosity remains somewhat of a mystery. The only apparent explanation is that the motivation for the court's approval of valuation based upon original cost less depreciation—to avoid an award reflecting an excessively low scrap value (zero in the case of the tunnel properties)—was extended to permit a going concern value premium. Here X will presumably be substantial.[239] The GPs' arguments indicating that earnings values from the EL's main freight lines are in part dependent upon continuing its passenger lines in rail use, see pp. 231-33, *infra*, further distinguish *PATH*.

Quite apart from these distinctions we would be hesitant to conjecture a condemnation premium based on these New York cases. We have previously expressed our disagreement with *Fifth Avenue Coach, CMV Opinion,* 445 F.Supp. at 1022, as well as with the going concern value holding of *PATH, CMV Opinion,* 445 F.Supp. at 1037 n.54, and indicated how Justice Cardozo's opinion in *Roberts* v. *New York,* 295 U.S. 264 (1935), relied upon by both the majority and dissent in *PATH,* was unhelpful in assessing its merits, *CMV Opinion,* 445 F.Supp. at 1028-29. Rejecting any going concern value premium above a base award of X for a losing operation seems most in accord with previous pronouncements on the question. This is true even when the claim for going concern value is not a percentage of the physical values, a position rejected in *PATH* itself, 20 N.Y.2d at 471-72, see also *Galveston Electric Co.* v. *City of Galveston,* 258 U.S. 388, 393-96 (1922) (claim of confiscatory rate), but costs of the sort claimed by Shannon that would in fact be incurred in inaugurating operations. The reason is the same as that for rejecting gross liquidation value. The condemnee is entitled only to the value of its next best alternative, to wit, sale for scrap; trained personnel, operating records, etc., would have had no value in such a sale. As said in the *New Haven Inclusion Cases,* 399 U.S. 392, 482 (1970), a hopelessly losing railroad cannot be treated

"as a liquidating enterprise with respect to certain items and as an operating railroad with respect to others, depending on which happens to yield the higher value." See also *Kimball Laundry Co.* v. *United States*, 338 U.S. 1, 9 (1949); *New York, New Haven & Hartford R.R.* v. *United States*, 289 F.Supp. 418, 435 (1968).

This line of decisions is particularly important because a New Jersey court would not be bound by the New York decisions. While technically the New York Court of Appeals in *PATH* applied New Jersey law to the condemned property in New Jersey, all the court had to say on that score was that New Jersey law was similar to the general rule followed in New York and in the federal jurisdiction and that the case before it was *sui generis*, rendering it impossible to make with certainty any statements predicting the reaction of the New Jersey Supreme Court. No New Jersey cases following *PATH* have been cited to us and we are not aware of any. Thus, there is no good reason to take the going concern value portion of the *PATH* opinion as indicative of what New Jersey courts would decide New Jersey's own law to be in a condemnation of the Ts' passenger lines. And there can be little doubt that public officials would not have paid such premiums by way of settlement for fear that a New Jersey court would have followed the going concern value holding of *PATH*. See, *e.g.*, Stangl (S) (Nov. 1, 1979) at 28-29; Stangl (D) (Mar. 25, 1980) at 419-20 (New Jersey), 19 GP Supp. App. at 743-44; Tennyson (S) (Nov. 1, 1979) at 5, 9-10 (Pennsylvania); Schuler (D) (Apr. 29, 1980) at 253-54 (New York), 19 GP Supp. App. at 786-87.[240] We thus need not rule on the GPs' argument that for this court to recognize a premium based upon a state court's decisional law that is in conflict with federal condemnation law would violate principles of federal supremacy.

Finally, EL refers to some past public acquisitions of railroad property as a basis for its claim that New Jersey would have paid some premium over X. Rather than present any substantial testimony concerning these transactions on its own, EL relied

almost exclusively upon evidence offered by PC, and advanced by R after PC settled, in support of its claim for premiums 50 percent in excess of X for publicly acquired passenger lines. See ELP at 67 n.60 (LIRR) (citing Ronan and noting "other transactions referred to by him"); ELRB at 28 & n.24 (Rutland Ry.), citing 3 CRA (S) (Dec. 1, 1978) XIV at 1-45. This evidence includes a massive study performed for PC by the Charles River Associates (CRA) of historical transactions involving the acquisition of rail properties by public authorities. This was supplemented by the testimony of William Ronan, who, beginning in 1959, held a variety of high transportation positions, mostly in the State of New York. Although we agree with the Ts that information concerning past public acquisitions, properly applied, can provide useful guidance in predicting actions of public bodies in the alternative scenario, we find the Ts' evidence gives no support to their claims for premiums.

The CRA Study examined fifteen negotiated acquisitions by nonfederal public bodies of rail properties for continued rail use. The study calculated the consideration received by the railroad in each transaction and compared it with independently determined measures of "common basis".[241] Implicitly, the Ts ask that we equate the latter measure with X for the purposes of this litigation, with the result that the ratio of consideration to common basis would represent premiums actually paid.[242] "Consideration" was defined to include all benefits to the railroad that were intended as part of the agreed compensation for the conveyed property; thus it was not restricted to the cash actually paid, but included relief from operating deficits, tax relief, trackage rights, and any other concessions made by the public body. In 9 of the 15 transactions, consideration thus defined exceeded common basis.[243] The GPs criticized this study at great length, see 9 GP at App. X 1-138; 2 GPRB at N 20-29. We find it unnecessary to consider all the GPs' criticisms because we find a number of them sufficient to reject the study outright.

Appendix H

The GPs' analysis of the CRA Study falls into two categories: general methodology and reliability of execution. Defects identified in the latter category as a result of the GPs' devastating cross-examination of CRA witnesses are alone sufficient to destroy all credibility of CRA's evidence. These comprised substantial inadequacies in document collection[244] and failure to interview most of those involved in the transactions they studied.[245] The latter is particularly important given that CRA's methodology was to determine the value of benefits intended as compensation as perceived by the negotiating parties at the time of the transactions. It also appears that their investigative technique was at times most haphazard.[246] Even more troubling is that when conflicting information was received, that unfavorable to the Ts' desired conclusions was sometimes ignored.[247] CRA also relied upon doubtful legal conclusions wholly beyond their expertise.[248]

A substantial portion of the consideration received in the transactions as measured by CRA was the cash flow gain to the railroad due to relief from future operating losses.[249] This was calculated by the gains—measured by operating loss, or amount received by the railroad in the transaction under service contracts—typically for the year of the transaction and multiplying by ten to reflect the assumption that absent the transaction the operating burden would have continued well into the future. Even if we were to accept this approach, CRA's computations under it are seriously flawed. In one case, the benefit was determined by calculating the avoided costs of passenger service without subtracting the revenues derived from that service. See Lamond (D) (June 7, 1979) at 87-89 (PRSL), 13 GP Supp. App. at 356-58; 2 CRA (S) (Dec. 1, 1978) at VII 68. When service contracts were part of the transaction, CRA did not deduct the cost to the railroad of providing the service. On at least one occasion, the base figure, which in turn was inflated by the multiplier of ten, was grossly in excess of that used contemporaneously by the transferring railroad.[250] In other transactions,

CRA deemed past operating subsidies[251] and subsidies totally unrelated to the transaction[252] as part of the consideration.

Support for CRA's use of a multiplier of ten is also highly dubious. For the multiplier to be that high, assuming a 6 percent interest rate, operating losses would have had to be expected to continue for at least sixteen years. CRA (S) (Dec. 1, 1978) at 54-56. Yet there is no apparent basis to assume that losses would have continued for so long. The public bodies acquired the properties only after the prospect of such deficits made discontinuation of passenger services a serious possibility. See Nathan (D) (Apr. 15, 1979) at 379-80, 15 GP Supp. App. at 215-16. Available evidence in a number of transaction indicates that losses would have continued for only a few years,[253] suggesting that a multiplier closer to two might have been in order.

More disturbing is evidence suggesting that the multiplier of ten was not merely an arbitrary choice but rather a figure derived after the fact to ensure that CRA's study reached conclusions favorable to the Ts. It appears that CRA had originally used a multiplier of 4.31, based upon the assumption that operating losses in the absence of the transaction would have had a five year duration. It was admitted that the decision to move to a factor of ten might have been made after CRA began receiving the common basis numbers against which their consideration figures were to be compared. J. Boyd (D) (June 7, 1979) at 376 (Methodology), 9 GP Supp. App. at 165. CRA did not indicate any new information upon which this change was based, see J. Boyd (D) (June 19, 20, 1979) at 283-84 (West End), 446-47 (Harlem-Hudson), 9 GP Supp. App. at 220-21, 238-39; LaMond (D) (June 7, 1979) at 15, 71-72 (PRSL), 13 GP Supp. App. at 346, 354-55; Wise (D) (June 8, 1979) at 91-103 (Cleveland), 21 GP Supp. App. at 701-13, and the GPs are persuasive in refuting Boyd's contention that the original 4.31 factor was merely a placeholder, later to be replaced by some other figure that was being independently determined.[254]

We also find the theory offered to justify the inclusion of avoided future passenger deficits unpersuasive. Where consideration was based upon payments for service contacts, it is consideration for those services, not for the properties conveyed. See Nathan (S) (Nov. 1, 1979) at 41; Nathan (D) (Apr. 18, 1980) at 872-73, 15 GP Supp. App. at 232-33; Netzer (S) (Nov. 1, 1979) at 16-17; Prince (S) (Nov. 1, 1979) at 9 (West End), 14 (Harlem-Hudson); Salvucci (S) (Nov. 1, 1979) at 3 (B&M). This much was virtually conceded upon cross-examination. J. Boyd (D) (June 7, 1979) at 454-56 (Methodology), 9 GP Supp. App. at 192-94; Ronan (D) (July 9, 10, 1979) at 248, 337, 17 GP Supp. App. at 501, 541. In the alternative scenario, public bodies would have had to make additional payments for these services, whether provided by themselves or contracted to other operators. See Ronan (S) (Dec. 1, 1978) at 92 (MTA and the Connecticut Transportation Authority "[s]urely" would not have paid these "staggering" amounts of future operating losses in cash for the Harlem-Hudson and West End properties); Ronan (D) (July 10, 11, 1979) at 337, 511, 586, 17 GP Supp. App. at 541, 586, 611. Finally, even if such consideration were significant, it would be of no help to the Ts' claims for premiums because the Rail Act has already provided equivalent compensation by relieving them of future operating deficits. To the extent the actual cash paid in historical transactions must be augmented to reflect this benefit, so the cash due from the federal government need not cover the future operating losses that the government has already taken over. In fact, the Ts' theory suggests that the GPs would have been entitled to claim the benefit of relief from anticipated future passenger operating losses as an offset to the awards claimed by the Ts. *Cf.* p. 236, *infra* (special benefits doctrine).

CRA's use of common basis data is also questionable. CRA makes no claim that these valuations were based upon the beliefs of the parties at the times of the transactions. See CRA (S) (Dec. 1, 1978) at 30; J. Boyd (D) (June 6, 1979) at 180-81; 223-24 (Methodology), 9 GP Supp. App. at 96-97, 122-23. These

beliefs are important in predicting public body actions in the alternative scenario because prices can only be based upon X as perceived by the parties to the negotiations, and not upon some other figure determined by hindsight. Throughout its study, CRA explicitly used calculations differing from those of the parties and included elements not known to the parties, particularly in connection with appraisals of common basis. See, *e.g.*, J. Boyd (D) (June 6, 7, 1979) at 185, 192, 329 (Methodology), 9 GP Supp. App. at 98, 103, 146; Gillan (D) (Apr. 25, 1979) at 343, 9 GP Supp. App. at 777; 2 CRA (S) (Dec. 1, 1978) at I 35-36; Caust-Ellenbogen (D) (July 3, 1979) at 71-74 (SIRT), 9 GP Supp. App. at 481-84; Nathan (S) (Nov. 1, 1979) at 9; note 251, *supra*, p. 226, *infra*, (appraisals in B&M and LIRR transactions). In addition, some of the common basis values used were contradicted by available appraisals.[255]

CRA's analyses of the LIRR and B&M transactions, which were cited by EL, exemplify some of CRA's errors. First, the actual cash paid in both transactions exceeded only slightly the so-called common basis for these properties. The figures for cash paid and common basis were $39.5 million and $37.5 million for the B&M, CRA (S) (Dec. 1, 1978) at 154, and $65 million and $63 million for the LIRR, *id.* at 119. Much of the "excess consideration" in the B&M transaction was attributable to the value of operating subsidies which a Massachusetts official denied were intended as compensation for the property conveyed; rather the money was paid for services B&M had contracted to provide. Salvucci (S) (Nov. 1, 1979) at 3. Moreover, in determining the common basis figure for B&M, CRA ignored an appraisal of two-thirds of B&M's conveyed real estate at a value over fifty percent higher than the figure CRA used for the whole. See Seymour (S) (Dec. 1, 1978) at 78; 9 GP at App. X 130. For the LIRR, Ronan's prior statements in 1967 and 1974 indicate that the cash paid constituted the whole cost to the MTA. Ronan (D) (July 9, 1979) Ex. 4 at 52; *id.* Ex. 6 at 964-65 (also indicating that "the real estate alone was worth more than the purchase price we

paid"). In addition, the common basis figure relied upon for comparison in the LIRR transaction is quite suspect.[256] Finally, as to the Rutland acquisition, contrary to EL's indication that a premium was paid, see ELRB at 28 n.24, no premium could be calculated, because PC consultants never came up with a common basis figure.

In short, we find CRA's method inapposite for determining whether any premium would have been paid by public bodies in the alternative scenario and conclude that in any event their data collection and computations are wholly unreliable. In fact, if one were to recompute the measures of consideration and common basis based upon the unrebutted criticisms of the GPs, the results would indicate that public bodies in these historical transactions paid less than common basis. However, especially since the underlying data is so unreliable, we accept the GPs' invitation to ignore CRA's study altogether.

Ronan's testimony purportedly provided independent support for the 50 percent premium. He asserts that the amount public bodies would have paid for the Ts' lines would have been dependent upon their social value: the least important would be valued at scrap, but those for which abandonment was completely beyond the realm of possibility would have brought a higher price. Ronan (S) (Dec. 1, 1978) at 79-80. He claims to find empirical support for his position in some of the historical transactions studied by CRA, and reasons that the public would have had no choice but to pay significant premiums because of the fear that a condemnation award would have been even higher. We do not, however, believe that Ronan's testimony adds anything to CRA's study or to EL's case for a premium based upon the desire of public bodies to avoid condemnation.

It is unclear how Ronan came to choose his 50 percent figure for the premium in excess of X. Neither he nor R contends that CRA is the source of this figure, and he did not perform his own study of appropriate values for consideration as compared to X for these historical transactions. He asserts that "[e]xperience,

. . . reinforced by CRA's analysis of the earlier transactions, demonstrates that the difference between the consideration paid and any measure of 'liquidation value' grows with the importance of the particular line to the public", Ronan (S) (Dec. 1, 1978) at 79, but does not provide any estimate of the value to the public in any of the transactions for which he noted CRA's ratios of consideration to common basis or even a hint of a reason suggesting that those transactions for which CRA found larger ratios involved more important properties. Ronan (D) (July 10, 11, 1979) at 459-64, 626-27, 632-33, 17 GP Supp. App. at 573-78, 624-25, 627-28. It is impossible for us to accept so large a premium based only upon very general theorizing followed by what seems to be little more than a guess.[257]

Ronan's theory seems to offer little more than repetition of EL's claim for a going concern value premium. His theory that premiums would vary with the importance of the lines is based upon his assumption that "importance is what establishes the bargaining position of the parties". Ronan (S) (Oct. 15, 1980) at 100. He relies heavily upon the notion that the public would have been under duress, and that the railroads thus would have had the ability to hold out for large premiums. See Ronan (D) (July 9, 10, 11, 12, 1979) at 63-64, 152, 301, 319-20, 325-26, 376, 641-42, 1048, 17 GP Supp. App. at 451-52, 485, 518, 526-27, 532-33, 559, 636-37, 772. Accepting as true the proposition that states would have been forced to condemn the Ts' passenger properties, a contention we reject at p. 234, *infra*, it is still unclear how the fear of having to pay a condemnation award somewhat higher than X would result in a 50 percent premium being paid in negotiations since the anticipated condemnation award places a ceiling upon what a public body would willingly have paid. Unlike EL's argument that condemnation might produce an award for going concern value based upon *PATH* and *Fifth Avenue Coach*, see pp. 219-21, *supra*, Ronan's theory of an award based upon value to the public lacks even a colorable claim to support in condemnation law. See, *e.g.*, *Boston Chamber of*

Commerce v. *Boston*, 217 U.S. 189, 195 (1910); *United States* v. *Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 80-81 (1913); *CMV Opinion*, 445 F.Supp. at 1013-16.

All that remains is Ronan's claim based upon historical transactions. R emphasized in its opening brief, RP at 39, 41-42, that Ronan's theory was amply supported by CRA's study. However, at other points and in reply, they emphasize Ronan's independence from CRA, RP at 64, RRB at 49-50. But, with one exception, we are not told on what other historical evidence he did rely. In the one transaction in which he was involved, his contemporaneous statements contradict CRA's conclusions. See p. 225-26 & n.257, *infra* (LIRR). Finally, he conceded that if CRA's ratios had come out differently, he would have had to reconsider his conclusions. Ronan (D) (July 10, 11, 12, 1979) at 276-80, 296-97, 603-06, 1028-29, 1068, 17 GP Supp. App. at 504-05, 516-17, 616-19, 769-70, 775.

In rebuttal to Ronan, the GPs offered the testimony of Edson Tennyson, Deputy Transportation Secretary for the Commonwealth of Pennsylvania from 1972 until 1979. Tennyson originally testified for North Penn, supporting its claim that public bodies would have acquired its passenger properties. At deposition, North Penn did not permit Tennyson to answer questions pertaining to the prices Pennsylvania would have paid. Tennyson (D) (Apr. 3, 1979) at 17, 26-27, 45, 48, 54, 20 GP Supp. App. at 711-13, 720-21, 724. When testifying for the GPs, however, he stated that he had thus far presented only half of his story and volunteered to appear as a GPs witness, without remuneration, in order to make the record complete, Tennyson (D) (Mar. 19, 1980) at 37, 20 GP Supp. App. at 731. Given his chance, Tennyson flatly stated that Pennsylvania would not have paid more than X for the passenger properties. Tennyson (S) (Nov. 1, 1979) at 4-5, 8-12.

The final attempt to rescue the claimed premium is R's evidence concerning Philadephia's offer of $472,441 for an easement over 3.5 miles of R's Chester Branch. But the circumstances

surrounding this acquisition are not comparable to those that would have prevailed in the alternative scenario where R and North Penn's passenger lines would have been acquired. Most notable is that the Chester Branch was not a passenger line. Moreover, there is no evidence indicating an estimate of X for this segment, so we cannot determine whether any premium was involved. Using the per mile figure derived by R from this example, the value of all their proffered passenger lines comes to $13.7 million, which is less than 25 percent of the $61 million claimed for their passenger properties and less than 35 percent of their $41 million estimate of X (without premium) for those lines. Finally, there is no evidence indicating the basis upon which the acquisition figure was derived by the parties to the transaction.

The GPs also played the game of basing conjectures of what would have happened in the alternative scenario on evidence of past transactions. They refer to the 1972 Southeastern Pennsylvania Transportation Authority (SEPTA) Memorandum of Understanding whereby all the Philadelphia area passenger properties were to be leased for a period of fifty years, subject to three fifty-year renewals, for which R and PC were not to receive any cash at all. Ex. GPS-Public Bodies-175, 176. This Memorandum was approved by R's reorganization court, but on appeal to the Third Circuit, the lower court's order was vacated and remanded for further proceedings in light of the Rail Act, which had just been enacted. *In the Matter of Reading Co.*, No. 73-1631 (3 Cir. Mar. 22, 1974). The GPs offered this as support for their argument that public bodies would demand deductions from X is setting prices, see pp. 231-33, *infra*, but, since the issues parallel those discussed in connection with the CRA Study and the other transactions, we consider the SEPTA Memorandum here.

In response to the GPs' argument that only one year before the Rail Act it had been willing to give away its passenger properties, R claimed that, in that case, it had in fact received substantial consideration. The most significant alleged consideration was

the public's assumption of R's passenger operations and their attendant deficits. This claim parallels CRA's inclusion of such relief as part of consideration in their study and is subject to the same criticism. R conceded at oral argument that including this benefit as an element of value would amount to "double-counting" since the benefit is already received as a result of the proffered acquisition by the public in the alternative scenario. Tr. at 506, see pp. 224-25, *supra*. Moreover, R's claim that it would have been able to abandon its passenger operations, 2 RF at 214-305, undermines the value of this alleged element of consideration.

A second element of consideration is the free trackage rights granted to R and PC for freight use of the passenger lines covered by the Memorandum. To demonstrate the magnitude of this element, R refers to an agreement by Chessie to pay Conrail $2.2 million annually for operating freight service over what had been R's passenger properties. The GPs note, however, that this was a reciprocal agreement under which Concrail was to pay Chessie a similar sum, Tr. at 352, casting doubt on the true value of trackage rights over these properties. By contrast, at the time of the Memorandum, PC valued the trackage rights over its passenger lines at only $1.6 million annually, Ex. GPS-Public Bodies-188 at 6, an amount seriously questioned as too high by PC's creditors, Ex. GPS-Public Bodies-178 at 28. And it is difficult to square R's valuation of trackage rights with JTTs' witness Jennison's estimate that the annual charge for Philaterm's use of the terminal passenger lines, excluding the Northeast Corridor, amounted to merely $68,774. Jennison (S) (JT) (Dec. 15, 1978) at 35, 52. Finally, even if free trackage rights were in fact extremely valuable, this simply supports the GPs' claim for deductions by indicating the importance of the Ts' passenger lines for freight traffic, see pp. 231-33, *infra*.

R also asserted that retained air rights were of significant value. However, since no quantification is available and since the Ts were only to receive half the proceeds from sales of air rights

after application to commuter deficits, see 4 GP at P 200, we cannot attribute any significant value to them. We thus conclude that the SEPTA Memorandum seriously undermines the claim that Ts would have received premiums for their passenger lines, and further suggests that prices less than X would have been likely.

(b) *Government Parties' Claim for Deductions from X*

Having dismissed EL's plea for prices for its passenger lines significantly in excess of X, we now consider the GPs' claim that public body prices would instead have reflected deductions from X. The argument begins with the observation that New Jersey's purchase of EL's passenger lines would have conferred a benefit upon EL to the extent that in the sale of its main freight lines it would have been able to derive additional earnings value attributable to traffic dependent upon the passenger lines' continued existence in rail use—an earnings value hereafter referred to as "D". From this premise the GPs argue that public bodies, seeking to pay no more than necessary for the Ts' passenger lines, would have deducted D from the X of those lines to arrive at the price they would have been willing to pay.

The theory can be explored from the perspective of the Ts' contention that profitable acquirers of their freight lines would not have purchased predominantly passenger lines under any circumstances, which leaves abandonment as the only private marketplace alternative. If any T would have pursued that alternative, it would have realized the full value of X from its scrap sale, but would have lost D on the sale of its main freight lines since their earnings value would have been diminished by that amount as a result of the abandonment.[258] Thus, EL's claim that X was "the minimum price which EL would have been required to accept on a sale made in order to keep those properties in rail use", ELRB at 290-91, simply misses the point. In

essence, the GPs' argument is that a state's payment of X, without deduction, for the passenger lines amounts to a double recovery since the affected T would receive the full benefits of two mutually exclusive dispositions of its passenger lines.

It is credible that a state would have followed the pricing rule urged by the GPs, since it derives from the more general principle of paying no more than the best marketplace alternative for the Ts' lines, see p. 218, *supra*. The GPs' presentation of testimony by public officials indicating that they would have insisted upon a wide array of other deductions, 4 GP at P 13-21, and that they would have taken into account the degree to which the profitability of the Ts' main freight lines would have been contingent upon the continued operation of public body lines[259] strongly suggests that the GPs' theory is a sound indicator of what would have happened in the alternative scenario. In fact, the GPs' position is little different from that advanced by some Ts in claiming that off-segment earnings should be accounted for in determining earnings value. See pp. 286-88, *infra*.

One caveat to this analysis is necessary. The deduction from the price to be paid for a passenger line cannot exceed its X.[260] D in excess of X is, after all, simply another way of stating that earnings value, broadly defined, see pp. 40-41, *supra*, exceeds X. When that occurs, it would be profitable to include the segment in the package with EL's freight lines rather than permit it to be abandoned. To a private acquirer, a predominantly freight line and a predominantly passenger line would be viewed equivalently to the extent that each made an equivalent contribution to earnings value, so long as responsibility for passenger operations was not linked to purchase of the track. The flaw in the Ts' analysis, see, *e.g.*, ELP at 64 n.58, lies in the inarticulated assumption that passenger operations and the rail lines themselves are inseparable. See Tr. at 311, 318 (GPs). *Compare* ELRB at 270-72, 290 *with id.* at 268 n.265 (essentially conceding the point). It is not necessary in determining the value of a T's property to resolve

whether a passenger line for which D exceeds X would be privately or publicly acquired. If it would have been the former, the sale price of the freight package would not be enhanced since the T's estimates of earnings value already account for the earnings attributable to these lines; if it would have been the latter, the private acquisition price is unchanged since the lines will continue in rail use and the public simply pays zero. Of course, in considering these deductions there remains the further caveat that the proceeds from the sale of the freight lines at earnings value combined with those from sales to public bodies cannot be less than X for the entire system. Whether this point will require consideration will not be known until completion of the nonrail use phase of the case.

Determining the amount of such deductions is more complicated. The Ts at no point offered any specific evidence on the significance of D. Although the CERL Study found that 44 percent of the freight revenues on the three T's lines derived from traffic exclusively served by public body lines, Waldner (S) (Jan. 30, 1980) at 11,[261] it did not distinguish between the predominantly passenger and predominantly freight lines. Yet there can be little doubt that the values of D for some passenger lines would have been quite significant. Shannon indicated that freight traffic on about half of the New Jersey suburban lines was "substantial". Shannon (D) (May 21, 1979) at 46-47. Figures submitted by both the GPs and EL in response to a letter from the court dated August 28, 1981, Sp. Ct. Rep. N 36850, discussed at pp. 237-44, *infra*, confirm this. We reserve consideration of the magnitude of the deduction applicable to particular passenger lines until after our discussion of bargaining between public bodies and the Ts.

(c) *Bargaining with Public Bodies*

Public bodies would have entered negotiations with the Ts for their passenger lines with two objectives in mind: avoiding the loss

of important rail service and keeping the purchase price to a minimum, see Ronan (D) (July 10, 11, 1979) at 305, 362-66, 631, 17 GP Supp. App. at 520, 551-55, 626. The latter desire would have been particularly acute given the large amounts at stake, the financial difficulties facing state governments at that time, and the publicity that would have accompanied any such transaction. See pp. 211-17, *supra*; 4 GP at P 96-102. The Ts' objective would have been to maximize the aggregate return from the sales of their property: the combination of the prices to be received from sales of their freight lines to profitable railroads and of their passenger lines to public bodies. We find that under these circumstances the public bodies would have had a strong upper hand, with the result that successful negotiations, avoiding the need for condemnation, would have yielded prices of X minus D for the Ts' passenger lines. *Cf.* pp. 41-42, *supra* (bargaining with only one bidder).

The source of the Ts' weakness in the bargaining is the dependence of the sales of their freight lines to profitable railroads upon the disposition of their passenger properties. See, *e.g.*, Altshuler (S) (Nov. 1, 1979) at 21, 26-27 (prospective solvent acquirers would have pressured Ts to dispose of public body lines rapidly to assure earnings on main freight lien acquisitions); Netzer (S) (Nov. 1, 1979) at 8-9, 41-42. To the extent that earnings on the main freight lines did not depend upon the continued operation of any particular passenger line, the deduction issue is moot since the D for such passenger lines would be zero. Conversely, the greater the applicable deduction, the greater by definition is the dependence of the freight sales upon public acquisition of the passenger lines and the weaker would have been the Ts' position in bargaining with the states.[262]

The only way a T could have extracted more from a public body would have been if it could have effectively threatened to abandon its lines and thus disrupt the state's commuter operations. But the Ts would have been unable to mount a persuasive threat for a number of reasons. First, such a threat with respect to a line

contributing significant earnings value to the main freight lines would not be credible on its face. Witnesses for both the Ts and the GPs agreed that cessation of operations by a T for any substantial period of time would have been irreversible.[263] It might be argued that similar damage would be inflicted on the public, but the public is in a much different bargaining position. Although harmful to the public, such action would amount to suicide for the T, and public bodies were well aware of this.[264] EL's witness Shannon had previously counseled EL against using the threat of shutting down in order to obtain bargaining leverage. Shannon (D) (May 23, 1979) Ex. 6 at 7.

In addition, the state would have realized that any particular T would have been a one-time player at the bargaining table. Thus no T could have hoped to gain from any enhanced credibility in future negotiations that might have resulted from actually carrying out the threat.[265] By contrast, the state is a repeat player that must bargain with other Ts as well as with other entities in related future situations, such as, for example, possible acquisitions of bus companies, Cahill (S) (Oct. 15, 1980) at 11, railroads not yet bankrupt, and a wide variety of other enterprises. Thus it has much to lose from giving in to any unreasonable demands of a T. See Stangl (D) (Mar. 25, 1980) at 420, 19 GP Supp. App. at 744.[266]

Finally, even if a T could mount a persuasive threat and overcome any ICC barrier to acting upon it, a state would have been able to resort to quick-take condemnation powers. See note 221, *supra*. Of course, condemnation was at the state's option. The Ts claim that a negotiated solution would have been most likely for a number of reasons. See, *e.g.*, ELRB at 291 n.294 (arrangement of financing easier for state with negotiated sale).[267] But the GPs are correct in noting that condemnation would be available, and, if the Ts held out for excessive prices, likely. Schuler (S) (Nov. 1, 1979) at 14 (referring to PC's Remsen line: ". . . I was convinced that, as a public official, it would have been irresponsible for me to offer any more to Penn Central than they

could have realized absent a state acquisition"). All that remains to be determined is what condemnation award would have been most likely if that course had been taken.

We have already dismissed the Ts' claim that premiums above X would have been awarded by a condemnation court, see pp. 218-21, *supra*. Here we note that it would have been appropriate, and thus reasonable to expect, that a condemnation court would recognize the GPs' theory for deducting D from X in determining an award. The reasoning is a simple extension of the principle of permitting offsets for special benefits.[268] The justification for the special benefits doctrine transcends mere metaphysics. It recognizes that the purposes behind the constitutional requirement of just compensation are both consistent with and served by the rule. See *Bauman* v. *Ross*, 167 U.S. 548, 584 (1897). It is consistent with providing justice to the condemnee since the purpose of compensation is to ensure that the one affected is not left worse off by the government's taking. *Id.* at 574. By hypothesis D is a measure of the gain in price from the private sale of the Ts' freight lines afforded by continued operation over the passenger lines, and is thus a correct measure of a deduction from an award for the passenger lines.[269]

It would be anomalous to consider "mere use of a railroad [to] be a special benefit if the owner of the [condemned] land may connect this establishment with the main line by spur tracks or the like", see 3 Nichols, *supra*, § 8.6203[3] at 8-180 to -181 & n.42, but not to consider the use of a railroad a special benefit if the owner of the taken property may connect its entire freight system directly with the now public railroad. Just as in more traditional applications of the special benefits doctrine, this benefit is not one generally received by a group of property owners. In this case the special benefit is unique to the Ts as they benefit from the taking in a different and far more significant way than does any member of the general public. And since the requirement of just compensation includes justice to the public, see *Garrison* v. *New York*, 88 U.S. (21 Wall.) 196, 204 (1875); *Searl*

v. *School District No. 2*, 133 U.S. 553, 562 (1890), a condemnation court would feel compelled to permit the deduction, which has the effect of dispersing widely the social benefits from the taking.

In order to avoid misunderstanding, we repeat two previously highlighted limits to the implications of our conclusions. First, the deduction urged by the GPs is limited by the actual contribution the publicly acquired passenger lines make to the Ts' sales. Second, a corollary to this proposition is that deductions would not be permitted to bring the total for all the Ts' properties below X for their entire system.

(d) *Magnitude of the Deductions*

The theory upon which the deduction argument is predicated, viewed in the context of the bargaining process just described, provides the basis for estimating the magnitude of deduction from X that would have been demanded by a public body in the alternative scenario. As we noted previously, see p. 233, *supra*, however, the briefs indicated only the qualitative significance of D, without providing the data necessary for computations. As a result, the court sent a letter on August 28, 1981 to counsel for EL and GPs, Sp. Ct. Rep. N 36850, requesting more focused information based upon materials in the record. The responses to this letter provide data indicating the total freight traffic moving over each of EL's predominantly passenger segments, broken down into the number of carloads originating or terminating on the segment, the number interchanged on the segment, and the number simply passing over it. The data also indicate how much system revenue derives from cars moving over each of the segments for each of the hypothesized EL-LV acquisition packages. Finally, the GPs performed some simple computations to indicate the earnings value that would be lost on the EL-LV system in the absence of traffic that moves over EL's predominantly passenger lines.

The parties' replies exhibited substantial agreement as to the answers to the court's questions; disagreement focused upon the implications of those answers. See, *e.g.*, Reply of the Erie Lackawanna Trustees to the Government Parties' Response to the Court's Letter Dated August 28, 1981, Concerning "Predominantly Passenger Lines" in the North Jersey Terminal Area (Sept. 21, 1981) at 1-3 Sp. Ct. Rep. at N 37082-4 (hereinafter EL's Sept. 21, 1981 Response); GPs' Reply to EL's Response to Court's Letter of August 28, 1981, (Sept. 21, 1981) at 1-2, Sp. Ct. Rep. at N 37071-72 (hereinafter GPs' Sept. 21, 1981 Response). In particular, EL conceded that its line from Port Morris through Denville and Boonton into Croxton Yard and Hoboken (Boonton line) "was essential to the profitability of the EL-LV acquisition". EL's Sept. 14, 1981, Response at 6, Sp. Ct. Rep. at N 36894. As to the remainder of El's predominantly passenger lines, the focus of EL's argument continues to be that they are not essential for the sale of the freight lines to a solvent railroad to go through. The GPs respond correctly that this does not address their claim that these lines contributed to the earnings value of the freight lines, with consequent effect upon the price New Jersey would have paid and the trackage rights fees it would have charged. GPs' Sept. 21, 1981, Response at 6, Sp. Ct. Rep. at N 37076.

The GPs' calculations indicate that in excess of $100 million of earnings value for the EL-LV system may be due to traffic moving on EL's passenger lines,[270] figures that rival EL's claim for $103.8 million in salvage value for these lines, see Shannon (S) (EL) (Dec. 31, 1978) at 92. Given EL's concession as to the essentiality of the Boonton line, it seems quite likely that a properly computed D will be in excess of X for the Boonton line, suggesting that New Jersey would have acquired this for a price only marginally in excess of zero.

The outcome for the other predominantly passenger lines is far less certain because the corresponding D's are much smaller than for the Boonton line and because we will not have conclusive

estimates of the X for any of the passenger lines until completion of the next phase of the case. Thus we must proceed on the assumption that D will not exceed X for at least some of the lines. This possibility raises a basic methodological question which we have thus far postponed: Must D be computed segment-by-segment, or is it satisfactory to estimate a single D for the passenger lines as a whole? The latter "package" approach essentially permits excesses of D over X on some passenger lines, such as the Boonton line, to overflow onto other lines, thereby diminishing or fully negating any positive prices that would be derived under an "itemized" approach for segments having an X greater than D.

Concededly, negotiations between EL and New Jersey in the alternative scenario probably would have produced a package deal rather than several line-by-line agreements. But the most reasonable assumption is that the price for the package would reflect estimates based upon figures for each segment. This follows from the fact that if New Jersey offered a lower price based upon, for example, the package methodology, EL could have followed the option of including any lines, such as the Boonton line, for which D exceeded X, shorn of responsibility for the deficit producing passenger operations, in the sale of its freight lines to a solvent acquirer, and abandoned the rest. Simply, EL would find it profitable to abandon any *segment* for which EL did not implicitly receive a price of at least X minus D from the State.

While we conclude that we must compute D for each segment, application of this principle is complicated by deficiencies in available data. To the extent traffic could be rerouted over freight lines, or concentrated on a few of the passenger lines, EL would have bargaining leverage as to those passenger lines upon which its freight movements were not truly dependent. But there is no testimony demonstrating the feasibility of rerouting freight traffic that historically moved over EL's passenger lines, or indicating over which lines such rerouted traffic might travel. To the extent traffic cannot be rerouted, there is no evidence indicating whether it could be loaded elsewhere, or whether the most likely

alternative loading points for such traffic would be onto the EL-LV system or some other. Finally, we cannot be certain of the amount of double-counting that would be involved in examining revenue figures for different passenger segments since some of the freight traffic moved over more than one segment. To be certain that no evidence was overlooked, we explicitly inquired about the "feasibility and cost or rerouting freight traffic from EL 'predominantly passenger' lines," Court's Sept. 24, 1981 Letter, Sp. Ct. Rep. N 37187. The parties' replies demonstrate that the record is essentially silent on the question. Government Parties' Response to Court's Letter of September 24, 1981, (Oct. 7, 1981) at 3-4, Sp. Ct. Rep. N 37235-36; Response of the Erie Lackawanna and Lehigh Valley Trustees to the Court's Letter Dated September 24, 1981, Concerning "Predominantly Passenger" Lines in the North Jersey Terminal Area (Oct. 7, 1981) at 5-6, Sp. Ct. Rep. at N 37258-59.[271]

We have made every attempt to elicit all record materials relevant to determining the magnitude of D and now must make the most reasonable estimate possible from available information. The first step is to estimate the traffic that would be lost if any particular segment were abandoned. We choose a base figure that includes all originating and terminating traffic and excludes the rest. Traffic that merely passed over a segment or was interchanged on a segment is that most likely to be reroutable. In addition, considering such traffic would lead to some double-counting since in many cases it originated or terminated on one of the other segments. By contrast, limiting consideration to originating and terminating traffic makes double-counting most unlikely since movements that both originate and terminate within the small area covered by the passenger lines are negligible. See ELRB at 275 & n.273. Moreover, originating and terminating traffic cannot directly be rerouted over another EL line, so it is the traffic most likely to move by some other mode of transportation, or move over some other carrier's system, in the event that the passenger segment was abandoned. The exclusion

of overhead traffic in estimating D results in some understating of the importance of the passenger lines for main line freight earnings because not all such traffic is counted twice and because rerouting is not costless. Including all originating and terminating traffic no doubt overstates the importance of some passenger lines. But in the absence of any evidence by the Ts concerning the feasibility of rerouting no other option is available. This base figure includes virtually all traffic on some of the smaller branch lines but excludes a significant portion (although not a majority) of traffic on the major lines into Croxton Yard.

Traffic Originating or Terminating on Passenger Segments:

*EL-LV Western Acquisition**

Line	*Cars O/T***	*Total Cars*	*Ratio*
Hoboken to Port Morris	148,022	213,060	.695
Croxton to Gladstone	1,058	3,615	.293
Croxton to Suffern	47,576	67,266	.707
Suffern to Sparkill	1,231	1,273	.967
NJNYE to Nanuet	7,839	7,848	.999
Hoboken to Rdgwd. Jct.	11,252	11,401	.987
Summit to Denville	5,861	6,376	.919
Newark to Montclair	341	341	1.000
Hoboken to Ptrsn Jct.	7,355	8,682	.847

* From GPs' Sept. 14, 1981, Response, Table C, Sp. Ct. Rep. at N 36885 and GPs' Sept. 21, 1981, Response to EL at 1 n.1, Sp. Ct. Rep. at N 37071.

** Refers to originating or terminating traffic. There is some traffic that originates and terminates on EL's passenger lines. Any overstatement that results from this double-counting is insignificant since EL's intrastate freight business "was by any standard negligible". ELRB at 275 & n.273.

From these base traffic figures, we derive a revenue estimate. We simply multiply the revenue figures attributed to all traffic on each of the segments by the ratio of originating and terminating traffic to total traffic. Although it is possible that the average revenue on carloads that originate and terminate on the passenger

lines is somewhat higher or lower than the average for all carloads moving over the passenger lines, it is doubtful that any such error is significant and no evidence has been produced suggesting that there is any error at all, or providing any way to correct for any imprecision that might result.

*Revenue Loss: EL-LV Western Acquisition**

Line	*Total Revenue*	*Revenue Loss*
Hoboken to Port Morris ...	72,852,084	50,613,494
Croxton to Gladstone	454,480	133,012
Croxton to Suffern	20,969,680	14,831,467
Suffern to Sparkill	477,037**	461,298
NJNYE to Nanuet	2,701,073	2,697,975
Hoboken to Rdgwd. Jct. ..	5,015,226	4,949,682
Summit to Denville	1,117,467	1,027,207
Newark to Montclair	118,351	118,351
Hoboken to Ptrsn Jct.	2,381,465**	2,017,470

* From GPs' Sept. 14, 1981 Response, Table C, Sp. Ct. Rep. at N 36885.

** These figures are derived by multiplying the revenue figures for these lines, GPs' Sept. 21, 1981, Response at n.1, Sp. Ct. Rep. at N 37071 by .9369, which is the ratio of Western acquisition revenues, GPs' September 14, 1981, Response, Table C, Sp. Ct. Rep. at N 36885, to historical revenues, GPs' Sept, 14, 1981, Response, Table B, Sp. Ct. Rep. at N 36884, for all but the Hoboken to Port Morris line, see GPs' Sept. 14, 1981, Response at 13-14, Sp. Ct. Rep. at N 36868-69.

Finally, we must estimate the earnings value attributable to the revenue that would be lost from the abandonment of each segment. We adopt the approach used, for example, by Shannon in determining the earnings value contribution resulting from projected increases in revenue on the EL system, Shannon (S) (EL) (Dec. 31, 1978) at 49 (Western acquisition), and by the GPs in their Sept. 14, 1981 Response, at 18-21, Sp. Ct. Rep. at N 36873-76. This method multiplies the figure for the change in total revenue by a factor indicating the excess of revenue over variable cost. This is reasonable because for relatively small changes in

traffic levels over a railroad's entire system, only variable costs are affected. For example, an increase in traffic of 2 percent would increase labor, fuel, and maintenance costs somewhat, but typically would require laying new track. Similarly, if traffic were to decrease 2 percent, the number of trains, level of maintenance costs, and overhead would not decrease by a full 2 percent. By contrast, if traffic levels were to change by a large magnitude, the concomitant change in costs would be more nearly proportionate, although still not one-to-one. See generally Jennison (S) (EL) (Dec. 31, 1978) at 19; Shannon (D) (May 21, 1979) at 99, EL App. A at 221. The 60 percent variable cost-to-revenue ratio used by Shannon for changes in traffic with the Western acquisition in the range of 6 percent, Shannon (S) (EL) (Dec. 31, 1978) at 49, is persuasively defended by EL in the context of arguing that it should be applied to its projected traffic increases. See 1 ELF at 79 n.64 (indicating use of similar ratios in prior ICC decisions); see pp. 263-64 & n.293, *infra*. The revenue loss that would result from abandonment of the Boonton line, however, is significantly in excess of that range. For this segment, Jennison's cost-to-revenue ratio of 71.4 percent, developed for application to an almost 20 percent decline in LV traffic volume in a region, Jennison (S) (EL) (Dec. 31, 1978) at 18, is most reasonable.[272] We need not determine comparable figures for the Chessie Acquisition for reasons given at note 151, *supra*.

Appendix H

Annual After-Tax Earnings Loss

Line	*Earnings Loss*
Hoboken to Port Morris	$7,237,730
Croxton to Gladstone	26,602
Croxton to Suffern	2,966,294
Suffern to Sparkill	92,260
NJNYE to Nanuet	539,595
Hoboken to Rdgwd. Jct.	989,936
Summit to Denville	205,441
Newark to Montclair	23,670
Hoboken to Ptrsn Jct.	403,494

The final step is to capitalize the annual earnings value estimates. The appropriate discount rate, 9.13 percent, was derived in Part VII. The resulting values for D as are follows:

*Magnitude of Deductions**

Line	*Deduction*
Hoboken to Port Morris	$79,274,148
Croxton to Gladstone	291,374
Croxton to Suffern	32,489,524
Suffern to Sparkill	1,010,510
NJNYE to Nanuet	5,910,132
Hoboken to Rdgwd. Jct.	10,842,677
Summit to Denville	2,250,180
Newark to Montclair	259,257
Hoboken to Ptrsn Jct.	4,419,430

* If D exceeds X for any segment, the price for that segment is simply zero.

We recognize that these estimates are imprecise. In addition to the reasons previously noted, a number of problems arise from using revenue estimates and variable cost ratios that are derived from historic information and do not reflect various adjustments

to the EL-LV pro formas noted elsewhere in the opinion. Our conclusion that the EL-LV figures overstate earnings values of the main freight lines because trackage rights fees for use of publicly owned passenger lines are understated, see pp. 244-51, *infra*, provides one example. Higher trackage rights fees imply a lower earnings value for traffic moving over the passenger lines, and thus lower values for D. Allowances for the labor protection costs on the main freight lines, see Part IX, *supra*, would have a similar effect. Beyond this, if EL had decided to abandon a passenger line because D exceeded X, this would entail further labor protection costs. Since, although the GPs devoted significant attention to the theory behind the deduction argument, neither party considered the issues arising in attempts to quantify its magnitude, we rest with the above figures as a fair approximation rather than attempting further refinement.

5. *Trackage Rights Fees*

EL's argument that "the State, once having acquired the commuter lines, would have granted the necessary trackage rights to the solvent acquirers", ELP at 17 n.14, neither addresses the question of what fee would have been charged nor indicates what assumption concerning acquisition price is implicit in the proffered testimony. The EL-LV pro formas are based on the assumption that the public body would have charged a solvent acquirer the avoidable maintenance cost for freight movements over passenger lines.[273] In sharp contrast, the GPs contend that public bodies would have included common costs, rehabilitation costs, and acquisition costs in the trackage rights fee. The GPs further argue that trackage rights fees would have been set to recoup from acquirers of the Ts' main freight lines as much of the new financial burden on public bodies as possible, attempting to share in the earnings values contributed to the main freight lines by the passenger lines. We find substantial merit in some but not all of the GPs' criticisms, and conclude that public bodies would

have computed trackage rights charges based upon an allocated cost formula that covered charges for both maintenance of way and rehabilitation, but not the acquisition cost itself.

First, it is necessary to determine the overall formula that a public body would have applied. The GPs present a number of cases where public bodies successfully resisted increasing passenger subsidies to cover anything more than the avoidable cost of the passenger operations. See, *e.g.*, Whitehurst (S) (Jan. 30, 1980) at 14 (New Jersey and PC), 17-18 (New Jersey and CNJ); Stangl (S) (Nov. 1, 1979) at 17 (New Jersey's historical unwillingness to pay any "freight costs" on the passenger lines). And the testimony of public body officials confirmed that these principles would have continued to govern decisions in the alternative scenario. See Altshuler (S) (Nov. 1, 1979) at 28-29; Stangl (S) (Nov. 1, 1979) at 21-22; Whitehurst (S) (Jan. 30, 1980) at 52-53. The Ts do not offer proof to the contrary. However, the GPs, despite their evidence, based all of their projections upon an allocated cost formula. See, *e.g.*, Government Parties' Response to Court's Letter of August 28, 1981 (Sept. 14, 1981) at 24 & n.18, Sp. Ct. Rep. at N 36879. Since this formula is both easier to compute and accords better with a sense of fairness in light of the heavy passenger traffic on these lines, it seems more likely than any other to have governed negotiations in the alternative scenario.

Deciding that the trackage rights fee would be based upon an allocated cost formula does not end our inquiry since there are countless theories upon which to base the allocation. Passenger traffic requires track to be maintained at a higher level than is necessary for freight both because frequent, moderate delays that may be of little consequence to freight movements can be a major disruption for commuter service and because passenger trains operate at higher speeds. On the other hand, in considering the level of necessary maintenance for heavy density freight lines (over 5 million gross tons per mile), Jackman, on behalf of the JTTs, assumed that track conditions should permit movements at

50 mph. Jackman (S) (JT) (Dec. 15, 1978) at 3. Since freight traffic is significantly in excess of 5 million gross tons per mile on the Boonton line, and very near that level on the Suffern line, GP's Sept. 14, 1981 Response, Table A, Sp. Ct. Rep. at N 36883, it cannot be said that most maintenance on EL's passenger lines is required only because of the existence of commuter traffic. Moreover, since freight cars are heavier, they cause more wear regardless of the level to which track must be maintained. For example, the presence of significant freight traffic would make it necessary to lay heavier rail and replace it more frequently. This is presumably the basis for the ICC's formula that allocates costs based upon gross ton miles. In fact, a gross ton mile formula was used to determine B&M's share of maintenance costs over its passenger-carrying lines that were acquired by the MBTA. See 2 CRA (S) (Dec. 1, 1978) at VI 63. Still, given the added requirements of passenger traffic, EL's witness' contention that allocation on a gross ton mile basis is unfair, Shannon (D) (May 22, 1979) at 250, EL App. N, at 78, has some force. We believe that the most reasonable allocation and the one that would have been agreed upon in negotiations between public bodies, the Ts, and acquiring railroads in the alternative scenario is a formula based upon car-miles. It is more generous to freight than the gross-ton-mile formula used by the ICC or the avoidable cost passenger formula that is supported by the GPs' witnesses although not advanced by the GPs themselves, but reflects more reasonably than either of the other two formulas the additional maintenance required for passenger traffic.

That the trackage rights fee would cover regular maintenance expenses is not disputed. The Ts assume, however, that rehabilitation would not be included. Yet no reasoning or evidence is offered in support of their position. As revealed in our discussion of rehabilitation expenses in Part VIII, the distinction between maintenance and rehabilitation is somewhat artificial. See pp. 86-87, *supra*. Rehabilitation is necessary when regular maintenance has lapsed. Both expenses are necessary to make the line

suitable for carrying traffic. It would be ironic for the Ts to avoid completely the burden of rehabilitating passenger lines that are necessary for their freight movements when their failure to keep them in adequate condition in past years caused their current condition.

At some points, the GPs argue that acquisition costs should be covered as well. Over lines for which D exceeds X, we have already concluded that the acquisition price would be near zero, so there is no acquisition cost to recoup. As to the others, where X exceeds D, inclusion of acquisition costs in the trackage rights fee would make little difference. We have already demonstrated that the earnings values attributable to publicly acquired lines, D, would be deducted from X in setting the purchase price while the Ts would have sold the main freight lines to solvent acquirers for the full amount of earnings values, see pp. 231-33, *supra*. Were the public to charge a trackage rights fee set to recover any portion of the acquisition cost, the value of the freight lines and thus the price any solvent railroad would have been willing to pay in acquiring them would be reduced by the same amount.[274] As a result, the acquisition price for the passenger lines must be reconsidered. Since that price equalled X minus D, every dollar by which D decreases leads to a one dollar increase in the price the public must pay. D represents the maximum that public bodies could extract through any combination of trackage rights fees and deductions from the purchase price for the passenger lines. On lines for which X exceeds D, the public has already extracted the maximum amount possible in setting the purchase price.[275]

It is more plausible to assume that D would have been deducted from X in setting the purchase price for the passenger lines than to assume that the public would have paid more for the lines and charged the difference in trackage rights fees. First, on lines for which D is less than X, a trackage rights fee set to recoup the full purchase price would, for the reasons noted above, induce the acquirer to cease operations over such lines since the trackage

rights charge would be in excess of the earnings value contribution of the traffic. As a result, to recover D through trackage rights fees reflecting acquisition costs, the fees would have to vary line-by-line to reflect differences in the ratio of D to X on each line, an unduly complex and unlikely arrangement. Second, higher trackage rights fees induce freight users to eliminate marginally profitable movements and divert others. It is more efficient, therefore, both in terms of resource allocation and collecting the maximum amount of revenue, for the public body to recoup D in a lump sum through a deduction from X in setting the acquisition price than through a usage charge reflecting acquisition costs.[276] Thus we have chosen to apply deductions to the acquisition price for the passenger lines and to exclude acquisition costs from trackage rights fees.

A final possibility that must be addressed is the GPs' suggestion that public bodies would use trackage fees to extract any additional earnings value. As noted previously, since acquisition price already reflects a deduction from X, the only lines over which any additional extraction would be possible are those having D in excess of X. But those lines would already be selling at a price near zero, and freight is already hypothesized to be bearing its share of maintenance and rehabilitation costs. Thus, if public bodies proposed trackage rights fees that were any higher, the Ts would simply have included the lines for which D exceeds X in the freight sale package, leaving the public bodies with the burden of conducting passenger service. We indicated previously that, for scheduling reasons and because of the ability to control maintenance more directly, public bodies would presumably have had a preference for ownership, especially since they inevitably would have owned the other passenger lines in the alternative scenario. But if the threat of excessive trackage rights fees were serious, there is no reason to doubt that those passenger lines that contributed in excess of their X to earnings value would have been privately acquired, with the public left to conduct passenger operations. Since none of the GPs' evidence suggest that the public

would attempt to go so far, apparently against its own interest, we continue to assume that New Jersey would have acquired all of EL's passenger lines.

All that remains is to compute the trackage rights fee. Our letter of Sept. 24, 1981, Sp. Ct. Rep. N 37178, requested the parties to provide information concerning trackage rights charges and maintenance of way and rehabilitation costs on the predominantly passenger lines because the briefs devoted virtually no attention to this issue. The parties' replies continued a heated controversy over the level of maintenance of way costs on the passenger lines and the proper allocation of these costs between freight and passenger users. In Part VIII we indicated why we find EL's maintenance of way figures more reliable than those presented by the GPs, see pp. 83-89, *supra*. Since there is sufficient evidence in the record to estimate maintenance of way costs on the passenger lines based upon EL's studies, we use them here as well.

We have no reason to question EL's figure of $1,987,000 for maintenance of way costs attributable to passenger service, which is taken from EL's Form R-1 for 1973. EL attributes $2,788,000 of its freight maintenance of way costs to freight traffic on the passenger lines. The figure is based upon the average system freight maintenance of way cost per equated track mile, which was multiplied by the number of equated track miles of the passenger line. See EL's Oct. 7, 1981, Response at 9 & nn.8-10, Sp. Ct. Rep. at N 37262. The GPs question the accuracy of such an approach, GPs' Oct. 7, 1981, Response at 9, Sp. Ct. Rep. at N 37241, but do not prove that the result is too low. EL's method provides a reasonable, although very rough, estimate, which we accept as the best available.

We have rejected Shannon's conclusion that freight's share of this $4,775,000 total is merely $733,000. See note 273, *supra*. We also are not persuaded by EL's repeated assertion that Shannon's figure is reasonable on the ground that the approximately $4,000,000 share it assigns to the State of New Jersey is a lesser

burden than the $4,300,000 assumed by the State in 1973 under its avoidable cost subsidy arrangement with EL. First, the evidence does not indicate the total maintenance of way cost or allocation formula upon which the $4,300,000 figure was based. The GPs are correct that it defies belief that passenger avoidable costs were approximately 90 percent of the total maintenance of way costs on these lines. EL's position also is hard to reconcile with its $2,788,000 figure for freight maintenance of way costs. In fact, EL refers to this figure as "the cost of maintaining the line for freight service," EL's Oct. 7, 1981, Response at 12, Sp. Ct. Rep. at N 37275; hence passenger avoidable costs for maintenance by definition must be at least $2,788,000 less than the total maintenance of way costs for these lines. Second, none of the evidence presented proves that the State actually paid $4,300,000 in 1973. The figure is taken from a study prepared for the State that arrived at a figure of $12,742,000 as EL's passenger deficit for 1973. EL App. O at 23-66. Yet other evidence relied upon EL demonstrates that in 1973 the State's subsidy payment was only $9,106,000. Ex. ELR-NJ-1 at 225, ELP at 16. Third, the GPs are correct in noting that "EL's position that no acquirer of its main freight lines would have acquired the 'predominantly passenger' lines (EL October 7 Response at 25) cannot be reconciled with EL's simultaneous contention that under its scheme passenger service would cost *less* than New Jersey paid under the 1973 contract. See *id.* at 3." GPs' Oct. 14, 1981, Response at 8, Sp. Ct. Rep. at N 37360. We therefore conclude that the most reasonable estimate of the maintenance of way component of the trackage rights fee New Jersey would have charged can be computed by directly considering our best estimate of the total maintenance of way costs on the predominantly passenger lines and allocating that cost based upon car miles of traffic.

The $4,775,000 figure must be adjusted to normalize the level of maintenance, which adds $133,650 to the total, see workpapers ELR 300 206165 (revised), Workpapers to Memorandum of the Erie Lackawanna Trustees in Response to the Court's Letter of

June 19, 1981 (July 10, 1981) at 30, yielding a total of $4,908,650. There seems to be little dispute that freight traffic constituted 56.2 percent of the total movements over EL's predominantly passenger lines on a car mile basis, see GPs' Sept. 14, 1981, Response at 25, Sp. Ct. Rep. at N 36880, which yields an annual charge of $2,758,661 to cover maintenance of way expenses.[277]

A further adjustment must be made to account for freight's share of other costs related to operation of the passenger lines. See GPs' Oct. 7, 1981, Response at 12 n.10, Sp. Ct. Rep. at N 37244.[278] The GPs indicate that they did not separately compute an appropriate figure, *id.*, so we must rely upon the only available estimate, which is that computed by Jennison in the context of the JT studies. The relevant figure is $.02199 per car mile, Jennison (S) (JT) (Dec. 15, 1978) at 33-35, which we multiply by the number of freight car miles, 15,426,404, Workpaper to EL's Sept. 21, 1981 Response, yielding an addition to the trackage rights charge of $339,227. The total annual charge is thus $3,097,888 not the $733,000 included by EL.

The solvent acquirer of EL's freight lines must also pay for its share of rehabilitation costs. We accept Shannon's overall estimate of these costs subject to the few minor adjustments noted in Part VIII and believe that an acquirer of EL's and LV's main freight lines would have paid 56.2 percent of the total cost of rehabilitation. The acquirer might have paid this amount to the public body as a one-time trackage rights assessment or might have performed the work itself and been reimbursed by the public body for its share of the bill.

XII. Proffers of Freight Lines at Capitalized Earnings—Issues Not Heretofore Considered

In this Part we consider a number of questions relating to proffers of freight lines at capitalized earnings with which we have not previously dealt. The largest portion of this Part will

relate to the EL-LV combination. We shall then pass on to AA and L&NE.

A. *The EL-LV Combination*

As indicated in Part II, EL believed that of the possible acquisitions proffered by it, the most attractive would be a combination of its main line with LV's line from Waverly, New York, to Northern New Jersey. LV's witnesses agreed that this also was the best disposition for itself. We agree with these positions.

The advantages of this combination would have been great. As discussed elsewhere, see Part II, both EL and LV had lines running from the NJ Terminal area to Buffalo. EL's main line continued on from Hornell, New York to Chicago. Almost 85 percent of LV's traffic originated or terminated on its lines between Sayre, Pennsylvania, near Waverly, New York, and the New Jersey terminal area, with only 15 percent of its originated or terminated traffic on the 172.6 mile line from Sayre to Buffalo. EL's line from Binghamton, New York, through Scranton, Pennsylvania, to the New Jersey terminal area generated less traffic than its line through Port Jervis and Suffern, New York, and almost all that was generated on the Scranton line could have been diverted to LV's parallel line from Waverly to Oak Island Yard near Newark. By abandoning EL's Scranton line and LV's route from Ithaca, New York, to Buffalo and routing the traffic of EL's Scranton line over LV's line and LV's traffic to and from points west of Waverly over EL's lines to Buffalo and Chicago, an acquirer could

> create a rail system with a compact network of rail lines, a relatively simple route structure, well clustered industry, and extremely high traffic densities.

Adik (S) (EL) (Dec. 31, 1978) at 4. Both Adik and Shannon testified that potential acquirers of EL's and LV's lines would have viewed this routing as extremely desirable and no GPs' witness disputed them on this point. See *id.*; Shannon (S) (EL)

CONTINUED IN VOLUME II

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No.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS
UNDER §§ 303(c) AND 306 OF THE REGIONAL
RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.,
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND
THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

APPENDIX
TO
JURISDICTIONAL STATEMENT

VOLUME II
Pages CA-525 to CA-927

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September 21, 1984

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This Appendix is submitted by the Appellants, which consist of Central Jersey Industries, Inc. and its subsidiaries, The Central Railroad of Pennsylvania, the Communipaw Central Land Company, the Dover and Rockaway Railroad Co., the Mt. Hope Mineral Railroad Co., the Wharton and Northern Railroad Company and the Bayshore Connecting Railroad. There are no other subsidiaries or affiliates of any of the Appellants except for certain wholly owned subsidiaries of Central Jersey Industries, Inc.

Appendix H

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed November 24, 1981, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Opinion With Respect to Valuation for Rail Use

(continued from Volume I)

XII. PROFFERS OF FREIGHT LINES AT CAPITALIZED EARNINGS—ISSUES NOT HERETOFORE CONSIDERED

This Section Continued from Page CA-524 of Volume I

(Dec. 31, 1978) at 39. Accordingly, our consideration will be devoted to a Western or Chessie acquisition of the EL-LV combination, which would include the sale of freight lines in Northern New Jersey in the package.[279]

Our discussion will deal with four topics:

(1) Whether or not there would have been competitive bidding for the EL-LV combination.

(2) The validity of the EL-LV earnings estimates.

(3) EL's claim for a $100 million enhancement in price because of New York's alleged willingness to make a grant of that amount to the purchaser of its route across the Southern Tier.

(4) The effect of our rejection of the JT proposal.

1. *The Existence of Competitive Bidding*

For reasons developed in Part V, we must face at the outset the question whether there would have been competitive bidding for the EL-LV combination. We find that there would have been.

The rock on wich EL's case with respect to competitive bidding was built was that the roads running west from the principal gateways of Chicago[280] and St. Louis would not have sat by and witnessed the disappearance of the only railroads that gave them satisfactory access to New York, Northern New Jersey, New England, and Southeastern Pennsylvania. The Chessie's route from Chicago to New York was exceedingly circuitous; the Norfolk & Western had none. The situation with respect to the Philadelphia area was similar, although Chessie's disadvantage was not so great.[281] Once one Western line moved toward an acquisition, whether of EL or, perhaps more likely, of a PC west-east IFL, others would follow. Chessie and Norfolk & Western, dismayed at the Western invasion of the East, would have entered the fray to blunt its effects so far as possible; indeed, they might have moved earlier in an effort to forestall the invasion.

EL offered two important pieces of evidence in support of this scenario. One was a study made on his own initiative by John Darling, Acting Director of Cost Analysis and Research of the Santa Fe.[282] The study is reproduced at Shannon (S) (EL) (Dec. 31, 1978) Ex. 1. He noted that EL and Santa Fe shared a number of common characteristics, including small amounts of branch mileage, reputation as high speed railroads, and major emphasis on trailer on flat car (TOFC) traffic. Darling's preliminary report concluded that after a six-year rehabilitation period, EL would contribute annual net after-tax income of $28,488,000 to the consolidated net income of the Santa Fe. This was projected to grow at an annual average rate of 15.4 percent until it leveled off to an annual growth rate of 5.1 percent ten years after the acquisition. These assumptions were predicated on an average inflation rate of 4.6 percent per year with no significant EL traffic growth. By becoming the first transcontinental railway system Santa Fe would have had important opportunities to gain new traffic, although these were not taken into specific account. While EL had been undermaintained, Darling did not think the road had deteriorated to the point reached by PC or some other bankrupts.

The report was distributed to members of Santa Fe's executive department, to Lee Hudson, Vice President of Traffic and to John Barriger, the Assistant to the President-Staff Studies, who expressed concern about retaliation by other railroads. A further study, made by Darling and signed by Robert Keyes, his supervisor, concluded that "the retaliation of any one or group of railroads in the northeast could not result in the long run diversion of sufficient traffic to negate the revenue gains of the traffic obtained by entering the northeast." Darling (D) (Jan. 31, 1978) at 30, EL App. A at 99.

Santa Fe concluded not to pursue the matter, apparently because of fear of opposition by other railroads.[283] However, Hudson contacted a Peter Lutken of Murchison Brothers. Hudson reiterated Darling's conclusion that EL could be operated

profitably and Santa Fe's concern that its interchange business, particularly the TOFC business, "would be jeopardized if Erie should fall into the hands of less friendly or less competent owners." Lutken (S) (Dec. 31, 1978) at 2. With Murchison's approval, Lutken contacted Maxwell, President of EL. No offer materialized. According to EL, this was because Maxwell was obliged to fix a two week deadline in light of the date set for Chessie's final acceptance of USRA's offer of part of EL under the FSP, *id.*

A much more elaborate study of EL was made by Chessie when, pursuant to the FSP, USRA offered part of EL to Chessie in 1975. This study involved several thousand man-hours of effort, with EL giving full cooperation and providing raw data that would not ordinarily have been made available. Two reports, presented to Chessie's Board of Directors on October 27, 1975, and November 19, 1975, showed that an EL acquisition would contribute net pre-tax income of $36.3 million and $30.7 million to Chessie's earnings. The difference is largely attributable to a reassessment of the operating costs and revenue gains from the additional EL traffic operating over Chessie's lines. The reports are reproduced at Shannon (S) (EL) (Dec. 31, 1978) Ex. 12, 13. These reports were prepared not to assist Chessie executives in negotiating with EL but to justify the acceptance of USRA's bargain offer.[284] Indeed, at a meeting of Chessie executives held prior to submission to the directors, serious question was raised whether the estimates of per diem charges were not too high by as much as $11 million a year and it was noted that all budgets appeared to be based on a very conservative approach, to the point that Chessie's President, H.T. Watkins, asked "Have we gone too far?" Watkins' attitude, and his direction that the Chessie study be kept confidential within top management, see White (D) (July 18, 1977) Ex. 13, EL App. A at 109-13, stand in considerable contrast to the comment of James White, author

of the study, much cited by the GPs, that "there was great sentiment [in Chessie] that said 'We are not interested in Erie, it's a dog' ". 3 GP at H 56-57 n.22.

The GPs naturally sought to downplay the force of EL's evidence. With respect to Western line acquisitions, they rely not only on the testimony of Barriger, see note 283, *supra*, and accompanying text, but on statements of Frank Barnett, former Chairman of the Union Pacific, Alan Boyd, former President of Illinois Central Gulf, and Thomas Lamphier, then President of Burlington Northern. Although Barnett, Barnett (S) (Nov. 1, 1979) at 3, strongly stated his belief that the Union Pacific "would [not] have been interested in acquiring any of the Penn Central's lines, or for that matter any of the lines of the Northeastern bankrupts (including Erie-Lackawanna's Chicago to New York line)", his two major reasons, massive rehabilitation costs and ICC-imposed labor protection costs, might not have been such important factors with respect to EL, see Parts VIII and IX.[285] Moreover, his professed disinterest in any of the east-west lines of the bankrupts contrasts strongly with his dire warnings in testimony to a Senate committee in 1973 about the effect on the national economy in general and the Western railroads in particular if Congress failed to enact the Rail Act, Shannon (S) (EL) (Dec. 31, 1978) Ex. 6; we cannot escape the belief that his avowed unwillingness to do anything to pull the Union Pacific's valuable chestnuts out of the fire stemmed from his belief that the government would and should perform the task instead. Boyd, as President of a north-south line, was naturally less preoccupied by the threat of a shutdown of the bankrupts. Moreover, his comments were addressed primarily to the IFLs. Lamphier, who had not read any of the evidence in the case, conceded that a shutdown of the PC lines from Chicago would have harmed the Burlington Northern; that if a competitive bid were made for a PC line, Burlington Northern would have been faced with a choice of attempting to block the offer before the ICC — a rather unlikely prospect — or submitting a competing bid. Cross-examination

developed a memorandum from Lamphier's predecessor as President to the then Chairman of Burlington Northern, Lamphier (D) (June 19, 1980) Ex. 1 (GPs), EL App. H at 78-81, making clear that acquisition of any PC or EL line by a competitor would have seriously impaired Burlington Northern revenues; that Burlington Northern would have gained revenues by acquiring one of those lines; and that EL's lines would have been among those considered. Altogether we cannot conclude that, with the number of Western lines available as purchasers, not one would have made a bid for EL. On the contrary, we think it highly likely that at least Union Pacific, Santa Fe, and Burlington Northern would have been bidders for the three available Chicago-New York lines, and that Southern Pacific, Missouri Pacific, and perhaps Union Pacific would have bid for PC's IFLs running east from St. Louis, especially the St. Louis-Harrisburg line, which afforded access to New York either via Amtrak through Philadelphia or via R and CNJ, and to Philadelphia through R. Since Missouri Pacific could not have been sure of obtaining PC's St. Louis-Harrisburg line, it might also have bid on one of the lines running east from Chicago to which it had access by its subsidiary, the Chicago & Eastern Illinois.[286] It seems highly likely that with this much prospect of Western lines entering the east, Chessie would have bid either for PC's water-level route between Chicago and New York, or for EL's route or the EL-LV combination between Sterling, Ohio, and the Northern New Jersey terminals. While the water-level route was doubtless the best route between Chicago and New York, Chessie would have encountered stiff competition from Western carriers on such a purchase and the EL-LV combination would have been less expensive since Chessie would not have been obliged to acquire 372.7 miles between Chicago and Akron, Ohio.[287]

In attacking the prospect of a Chessie bid for EL, the GPs begin, 3 GP at H 40, with abortive meetings between Chessie and EL officials during 1974, after the Rail Act had been passed but before EL had come under it, in which Chessie said that it "would

not consider acquiring the Erie Lackawanna, in whole or in part, under a Section 77 proceedings [sic]." We find this of little significance. For reasons indicated above, the Rail Act had ended the threat of a Western invasion, and if Chessie were going to acquire EL, it would obviously be preferable to do so under the Rail Act, with Government financing of labor protection, rather than without it. The GPs also argue that the collapse of USRA's offer to Chessie in the FSP, 1 FSP at 14, of a "package" consisting of "most EL freight services east of Sterling (Akron), Ohio, most of Reading services [plus] the Charleston, W. Va., market of the Penn Central and access to some CNJ traffic in the Elizabethport/Perth Amboy, N. J. areas", demonstrates that Chessie had no interest in acquiring EL. In fact, the collapse was due to the inability of Chessie to agree with certain labor unions that the protective conditions for workers on the acquired lines should be the same as those prevailing on Chessie rather than the much more liberal ones provided in § 505 of the Rail Act. The GPs also rely on figures developed during the negotiations. USRA had originally asked $114.1 million for the package, based on the net liquidation value or going concern worth of the various parts of the package, whichever was greater. USRA allocated only $14.9 million to EL as its liquidation value, since going concern value was estimated as negative. Chessie accepted on condition that the price be paid 20 percent in cash and 80 percent on B&O bonds, which USRA considered as a cash equivalent of approximately $62 million. Both sides having held fast for some time, Chessie moved to break the log-jam by offering, on October 28, 1975, $26.4 million for the R and PC Charleston properties but said that it had found EL to be "essentially without value" and was "concerned that EL's earning power was marginal or negative." Ex. GPS-PP-53 at 1. When USRA insisted on the sale of the package, Chessie raised its offer to $52.61 million. Agreement was ultimately reached at $54.5 million for the package, with Chessie emphasizing that "the maximum amount we can pay is net liquidation value. *Id.* 55 at 1.

We find little force in all of this. Chessie was toughly negotiating to pay as little as possible. How USRA could have come out with a net liquidation value of only $14.9 million for EL is beyond our conprehension; the FSP, 1 FSP at 142, had estimated this at $60.27 million. When Chessie was asserting to USRA that EL had no earnings value, it had in hand detailed confidential studies made by its own employees showing anticipated annual pre-tax earnings of $30.7 and $36.3 million — studies which its management thought might be too conservative.

In light of the foregoing, we find that in all likelihood there would have been competitive bidding for EL or a combination of EL and LV by Chessie, and by more than one Western line in the absence of the Rail Act. As for the Norfolk & Western, while we believe that EL has established that Norfolk & Western would have been interested in purchasing EL, EL has failed to establish how interested Norfolk & Western would have been. We cannot simply assume that the earnings studies which EL presented for the EL and EL-LV Chessie acquisitions can be applied directly to purchase by Norfolk & Western. Accordingly, we find that Norfolk & Western would not have been a factor in the bidding. A practical consequence of all this is that we need not overly concern ourselves with the value of an EL-LV Chessie acquisition since Chessie would pay at most only slightly more than a Western acquirer. See note 151, *supra*.

2. *The Earnings Projections for EL-LV*

The GPs summarize their belief that EL's earnings projections lack credibility when they say in their reply brief, 1 GPRB at F 19, that, although EL lost $4,729,000 in freight operations in 1973 (and had done worse in 1972 and was to do worse in 1974), the earnings projections assume first year net railway operating income ranging from $18 million to $37 million.[228] The GPs contend that EL offered no sufficient explanation for this

"remarkable rebirth of earnings power"; EL and LV claim they did.

The EL and EL-LV earnings projections rested on three essential building blocks. These are:

> (a) Studies by Laurie for EL and Adik for LV of the traffic and revenues which the restructured properties could expect either as part of a transcontinental railway system or as part of the Chessie;
>
> (b) Studies by Edward Jennison[289] and Adik of the cost of carrying this traffic;
>
> (c) Adjustments by Shannon to reflect additional revenue or lessened expenses not considered in (a) and (b).

(a) *Laurie's and Adik's Traffic and Revenue Studies*

We find it unnecessary to detail the methodology used by Laurie and Adik in making their traffic studies of the EL and combined EL-LV acquisitions since we are unimpressed with the GPs' criticisms that these did not adequately "evaluate the entire northeastern rail network of the bankrupts, including changes in ownership". 3 GP at H 78-79.[290] It would have been impossible to predict just what these changes would have been.[291] We are satisfied that Laurie and Adik did as well as could have been done with the information available to them, and, more importantly, as well as an analyst for a prospective purchaser would have done, and that any overstatements of added traffic due to reroutings are more than counterbalanced by the probability of other traffic gains that were not quantified, see, pp. 270-71, *infra*.

The attack on Laurie's and Adik's studies that does require serious consideration is that the "complete reliance upon a single year, 1973, which was an abnormally good year in the rail industry, created a significant upward bias in the results of EL's traffic studies." 3 GP at H 79.

Elaborating on this, the GPs seek to refute Laurie's justification, namely, that during the 1963-73 period EL's traffic had increased at a rate of approximately 2 percent per year, Laurie (D) (July 31, 1979) at 867-69, 13 GP Supp. App. at 491-93; Laurie (D) (July 31, 1979) Ex. 37, 13 GP Supp. App. at 502, by pointing out that the growth had occurred between 1963 and 1969, after which traffic declined each year until 1973.[292] The GPs also relied on the facts that in their profitability analysis of EL, R, and PC properties performed during 1973, Chessie officials concluded that 1973 had been "a very good year, and not representative", White (D) (July 22, 1977) at 548, 21 GP Supp. App. at 625, and considered traffic and revenue data from 1973, 1974, and the first five months of 1975, *id.* (July 18, 1977) at 74, 21 GP Supp. App. at 572; *id.* (July 19, 1977) at 198-200, 21 GP Supp. App. at 585-87; and that Chessie ultimately rejected 1973 data and used only 1974 and part-year 1975 traffic data, *id.* (July 19, 1977) at 199-200, 21 Supp. App. at 586-87; *id.* (July 21, 1977) at 405-06, 21 GP Supp. App. at 609-10. They relied also on the fact that Darling, in his study for Santa Fe, concluded that EL's traffic levels in 1975 and 1976 would be below those in 1973. Shannon (S)(EL)(Dec. 31, 1978) Ex. 1 at 59-60. However, they failed to inform us that Darling also thought that for the whole period 1975-84 EL freight traffic would "remain constant" at the 1973 level. *Id.* The GPs also relied on a forecast of the combined traffic of PC, EL, R, LV, CNJ, and AA prepared by GPs witness Robert Waldner, an employee of Temple, Barker & Sloane, the consultant in forecasting used by the GPs in this proceeding, from a "perspective of early 1976". 3 GP at H 89, *et seq.* Waldner found that over the 1976-85 period, traffic of the bankrupts would have somewhat increased, but that, for a number of commodities, comprising 48 percent of EL's freight traffic, volume would have declined from 1973 to 1978 by figures ranging from 2.9 percent to 15.5 percent.

EL points out that the drop from 1973 to 1974 was not particularly drastic, especially considering that 1974 was a year of deep

recession, and seeks to account for the sharp decline in 1975 on the basis that shippers were uncertain of EL's future in view of the uncertainty, not dissipated until our decision of April 11, 1975, *In the Matter of Erie Lackawanna*, 404 F.Supp. 954, whether EL would be allowed to reorganize under the Rail Act. However, EL's stronger answer is that matters should be viewed from the perspective of early 1974, by which time decisions on purchases would have been made, rather than with the hindsight of later years. Here EL draws great comfort from the fact that the GPs' own forecasting consultant, Temple, Barker & Sloane, in late 1974 and 1975 predicted in one study that EL's traffic level would exceed the 1973 level in the years 1977-80 and in another study that it would exceed that level in 1985, see Temple, Barker & Sloane, Forecast of Traffic and Revenues, 1974-1980, Volume III, Forecast of Conrail Traffic and Revenues, 1985 (Dec. 1974) at Ex. 1-1, EL App. O at 287.

We do not believe EL is to be faulted for using 1973 traffic and revenue data. As indicated in Part X of this opinion, discussions of the future of the bankrupts would have begun in 1973 and the purchase price would have been established in early 1974, even though ICC approval would not have been obtained that soon. Nineteen seventy-three would thus have been the last full year for which data would have been available, and developments in early 1974 would not have indicated that it was untrustworthy.

(b) *Jennison's and Adik's Cost Studies*

Jennison's and Adik's expense estimates were prepared as follows: EL and LV freight costs were broken down into "unit costs" representing costs per car originated or terminated, costs per car interchanged, and costs per loaded car mile. These were then multiplied by the related counts of service units. In the studies relating to EL alone, the only costs eliminated were:

(1) The expenses of operating and maintaining the EL docks at Hoboken and the EL car floats that had operated

in New York harbor. This was done because Shannon had concluded that neither a Western line nor Chessie would have acquired these facilities.

(2) Property taxes to New York State and its municipalities. This was done on the basis of testimony by Louis Rossi of the New York Department of Transportation that the State and the municipalities would have committed themselves to exempt EL properties from taxation as an inducement to the acquisition of EL by a profitable railroad.

(3) A portion of the property taxes in New Jersey and of the payroll taxes attributed to the New Jersey freight service.

(4) Maintenance of way expenses attributable to the EL suburban lines in New Jersey, which would have been acquired by the State.

(5) Maintenance of way expenses attributable to non-acquired branch lines.

In the EL-LV studies Jennison eliminated all New Jersey state taxes, and certain other expenses for the handling of EL and LV traffic in New Jersey on the ground that the EL and LV lines would have become part of the NJ/NYTerm, and substituted the trackage rights fees and switching charges calculated in the JTs study, Jennison (S)(EL)(Dec. 31, 1978) at 15, 17. In the EL-LV studies, it was recognized that because of the much heavier movement over LV's line resulting from the abandonment of EL's Scranton line, its 1973 maintenance of way expenses would have been inadequate. Hence the experts eliminated these expenses and the EL maintenance of way expenses for traffic that would now move over LV's Waverly-Northern New Jersey line, and Adik developed a detailed study of normalized maintenance requirements adequate to handle the increased traffic. These did not include overhead items since Shannon concluded that most of

such items would be eliminated if LV became a part of EL and made separate provisions for those that would not be. Jennison also eliminated LV dock and car float expenses and New York and certain New Jersey property taxes for the same reasons indicated with respect to his EL studies. In the case of the Chessie acquisition, costs of the movement of EL-LV traffic over the B&O line west of Sterling were computed on the basis of the B&O 1973 ratio of variable costs to systems revenue, to wit, 77.6 percent.

The first principal attack by the GPs on the expense estimates is that EL's earnings studies substantially understated the switching charges that would have been charged by the public bodies in Northern New Jersey. However, since we reject the JTs case and find that the acquirer of the EL-LV main line would have acquired the EL-LV JT properties as well, we do not have to deal with this problem. As already discussed, the GPs further claim and we agree that the trackage rights fee estimated by EL for use of the passenger lines was too low. See pp. 244-51, *supra*.

The GPs also claim that Jennison improperly calculated the cost of handling:

> (1) former LV traffic considered to move over EL's lines west of Waverly, N.Y., in the assumed EL-LV combination acquisition, and (2) former EL and LV traffic considered to move over B&O's line between Sterling, Ohio, and Chicago, in the assumed Chessie acquisitions of EL and LV lines.

3 GP at H 155-56. Jennison's theory was that "modest" increases in traffic of up to "20 or 25 percent" could be handled on an incremental cost basis, which in EL's case he estimated to be 71.4 percent of revenues, Scheer (S) (Jan. 30, 1980) at 15-16, as opposed to a full freight cost to revenue level of approximately 97.3 percent, EL 1973 Form R-1, Schedule 310; Jennison (S) (EL) (Dec. 31, 1978) App. 1 at 4; *id.*, App. 3 at 2. For traffic increases over 25 percent, Jennison applied a "variable" cost-

revenue ratio, which was an average of EL's full and incremental cost-revenue ratios. See pp. 242-43 & n.272, *supra*. The GPs assert, 3 GP at H 156 n.66, that application of B&O's variable cost ratio of 77.6 percent rather than its full cost ratio of 93.5 percent to Chessie's acquisition of the EL-LV package accounted for an increase to annual net income of $10,730,000.

A principal difficulty facing the GPs is that they produced no expert witness to testify that full costs should have been charged. Common sense tells us that unless a railroad is operating at capacity, some additional traffic can be accommodated at less than full cost. See p. 242, *supra*. There is no suggestion that the LV line between Waverly and Northern New Jersey was operating at anything like capacity; indeed, in another context, the GPs tell us that the LV was "starving for traffic". 3 GP at J 18. There is also no evidence that the B&O line between Sterling and Chicago was operating at capacity. Chessie in its own study applied incremental costs to EL traffic that would move over its lines as a result of rerouting, White (D) (July 20, 1977) at 347, EL App. N at 716; Sparrow (D) (Mar. 17, 1978) at 135-49, EL App. N at 731-45. Application of incremental or variable costs to added traffic was no invention of Jennison's; it is in general use by railroad experts throughout the country, see, *e.g., Rules to Govern the Assembling and Presenting of Cost Evidence,* 337 I.C.C. 298, 305-09 (1970). We see no reason to question Jennison's use of variable and incremental costs.[293]

The GPs also attack Jennison's use of a system average switching cost for work performed in the allegedly higher cost Northern New Jersey area. Although the GPs do not explicitly say so, this argument has little relevance to a Western line acquisition since all major yards were included and any understatement of New Jersey switching costs resulting from the use of a system average would be compensated by overstatement of such costs elsewhere. However, the GPs make a superficially appealing argument on this subject with respect to a Chessie acquisition. Since, in that proffer, the Chessie did not acquire EL lines west of Sterling,

Ohio, where switching costs are assumedly lower than those in the Northern New Jersey area, the use of a system average switch cost that included the allegedly efficient yards west of Sterling would tend to understate costs on the Eastern portions of the EL's lines. EL responds, ELRB at 122-24, we think correctly, that the GP's argument rests on the assumption that because switching costs in Northern New Jersey are higher than average, switching costs west of Sterling must be lower. The only testimony in the record on this point shows that the GP's assumption is wrong. Jennison testified that he believed the Marion Division (west of Sterling) switching costs were close to the system average, Jennison (S) (EL) (Dec. 31, 1978) at 14; Shannon testified that in his opinion Marion Division switching costs were higher than the system average because of inefficient operation in the deteriorated and antiquated Marion Yard. Shannon (S) (EL) (Dec. 31, 1978) at 12-13.[294] The GPs offered no evidence on this point

(c) *Shannon's Further Adjustments*

Shannon projected that by the fifth year after acquisition, net railway operating income would be substantially improved as a result of operating savings.[295] The principal items were:

(1) Savings in operating expenses from the rehabilitation program;

(2) Savings from the modernization of EL's classification yard at Marion, Ohio;[296]

(3) Savings from rebuilding EL's classification yard at Croxton, New Jersey;[297]

(4) Savings from single tracking EL's main line between Binghamton, New York, and Northern New Jersey via Port Jervis, New York, and in the case of acquisition of EL alone, parts of El's line between Binghamton and Northern New Jersey via Scranton, Pennsylvania.

While not denying the probability of some savings with respect to each of these items, the GPs argue that the amounts estimated by Shannon were so large that a purchaser would have viewed them with suspicion, especially since these items represented significant portions of total net railway operating income. Specifically the GPs say that:

> (1) It was error for Shannon to estimate the savings in overall expenses from rehabilitation and increased annual maintenance would be 5 percent of these sums, rather than to make a detailed examination of individual expense categories;
>
> (2) A potential acquirer would have viewed with suspicion Shannon's shift from an estimate of $3.4 million in annual savings from reconstruction of the Marion Yard made in the spring of 1973, Shannon (D) (May 25, 1979) Ex. 32 at 1, to an estimate of $6.4 million made in the fall of 1974, Shannon (D) (May 21, 1979) Ex. 1 at workpaper 206405, and would have wondered why a project with such stupendous savings, which EL admitted had been under continuous study since the mid-60's had not been completed long ago;
>
> (3) The plans for upgrading Croxton Yard were so incomplete that it was impossible to make any reasonable estimate of annual savings;
>
> (4) The plans with respect to single-tracking the Port Jervis line and parts of the Scranton line were likewise too indefinite for a purchaser to take savings from them into account.

We find little force in the GPs' criticism of Shannon's estimate of a savings in operating expenses of 5 percent of the total amount expended for rehabilitation and added maintenance. He explained that his long experience in the railroad industry had

taught him that companies generally figure on a 10 percent return on such expenditures, half of which takes the form of adding to or avoiding loss of revenues and half the form of reduced expenses. The benefits from rehabilitation and improved maintenance will also show up in the catastrophe accounts with consequent savings in overtime to train and yard crews and maintenance of way labor. These accounts amounted to between $18 and $19 million in 1973, and Shannon's projected savings represented only a 7 percent reduction in these expenses. We see no reason to believe that a purchaser would have doubted that a large program of rehabilitation and added maintenance would have produced this much of a saving in operating expenses; certainly the GPs adduced no credible evidence, expert or otherwise, to that effect.

The GPs' criticism of the Marion Yard figures are also lacking in force. This was a well-developed project, which the EL Trustee and management had submitted to the bankruptcy court and for which banks had committed to lend the funds. The commitment had been obtained on the strength of two reports by the independent engineering firm of Ford, Bacon & Davis. Both the cost of the project and the anticipated savings had been increased in the second, more detailed, report. We perceive no reason why a prospective buyer would have become suspicious over Shannon's use of these figures.

Omitting the Croxton Yard project, which would not have figured in the acquisition of an EL-LV combination, and the single tracking of parts of EL's Scranton line, which would have been abandoned in such a combination, we find equally little force in the GPs' objection that Shannon estimated an excessive "return" on the single-tracking of the Port Jervis line. The only substantial cost in such a project is the labor in picking up abandoned track, a cost that is largely offset by its salvage value. This work, as pointed out in a report by EL's operations planning department, Shannon (D) (May 21, 1979) Ex. 1 at workpaper 206344-206400, El App. N at 140-99, can be performed over any

convenient period of time. Nevertheless the savings begin immediately once the decision is made to stop maintaining one set of tracks.

The GPs' heaviest attack was reserved for Shannon's estimate of consolidation savings. These, they point out, also produce a very large share of projected net railway operating income. They claimed that Shannon relied on nothing more than judgment and the application of a supposedly universal but undisclosed "Wyer Dick formula".

The EL's opening freight brief, 1 ELF at 98-105, contained a detailed explanation of Shannon's method of estimating consolidation savings which showed that the GPs had either seriously misunderstood or mischaracterized Shannon's testimony. Railroad mergers fall into two general categories, parallel and end-to-end, although any particular merger is likely to have some characteristics of each. Parallel mergers provide an opportunity for savings by elimination of duplicative facilities and concentration of traffic on fewer lines. Organizational savings, which can be realized in both sorts of mergers, occur because the combined railroads do not need as many executives, lawyers, accountants, and traffic salesmen as had the two separate companies. Accounts particularly susceptible to reduction are the supervisory accounts, including the heads of the maintenance of way, maintenance of equipment, and transportation departments and their staffs; traffic department expenses, including the salaries of sales executives and field personnel and rental expenses for sales offices; and general expenses, including the executive, accounting, law, and medical departments. Employing the same general method as Wyer Dick had used in many railroad mergers since 1955, Shannon projected that either a Western purchaser or Chessie could have achieved savings of 50 percent of the expenses in the maintenance of way, maintenance of equipment, and transportation overhead accounts, 90 percent of the traffic department overhead,[298] and 70 percent of the general expenses. Shannon (S) (EL) (Dec. 31, 1978) at 59. He testified that he had checked his

results against those obtained by use of a different formula developed by John Barriger, another recognized expert in estimating merger savings, and found the results to be consistent. *Id.* at 59-60. He said also that he had compared his results with those of the Chessie study and found Chessie's figures also to be generally consistent. *Id.* at 84. He further concluded that in the EL-LV acquisition, almost all LV overhead expenses could be eliminated—a reasonable conclusion since, for all practical purposes, the acquired LV line was simply replacing EL's Binghamton-Scranton-Northern New Jersey lines and the overhead incident to the latter should be adequate to support the former.

The GPs presented the testimony of Albert Moon,[299] who stated that he "would not advise an investor to take such estimates [as Shannon's] into account in arriving at a proposed purchase price." Moon (S) (Jan. 30, 1980) at 88. Without going into exhaustive detail, EL's opening brief placed Moon in a state of nearly total eclipse. No investor had ever asked Moon's advice on such a question. He had no opinion whether Shannon's results were right or wrong; his sole point went to Shannon's methodology, which he erroneously conceived as being a mechanical application of the average results of Wyer Dick predictions of savings in five other railroad consolidations.

The GPs' reply brief made scant attempt to remove the shadow. Rather it dwelt upon the somewhat semantic question whether Shannon had or had not used a "formula" based on earlier Wyer Dick studies and the need for a sufficiently "property-specific" study.[300] Beyond this the GPs rely on statements by their financial witnesses, Jones and Smith, both of First Boston Corp., as to the uncertainties of projected merger savings, Smith (S) (Aug. 26, 1980) at 2166-67 (by Jones), 19 GP Supp. App. at 433-34; Smith (D) (Aug. 4, 1980) at 100 *et seq.*, 19 GP Supp. App. at 5, and 19-51, and to more extreme positions taken in extracts from a number of official sources. However, as pointed out in EL's reply brief, ELRB at 106, these extracts do not make clear whether they were directed at savings of overhead, which constituted the

bulk of Shannon's estimate, as distinguished from operating savings, which admittedly are more difficult to predict with accuracy.

In support of Shannon's estimates, EL brought out, 1 ELF at 349-53, that in the two of the three mergers that had been consummated substantially in the form that Wyer Dick had studied,[301] the projected consolidation savings had actually occurred. Lamphier, President of the Burlington Northern, stated that Wyer Dick's estimate of the consolidation savings in the Burlington-Great Northern-Northern Pacific merger had been achieved, and indeed surpassed. Lamphier (D) (June 19, 1980) Ex. 12, El App. H at 76-77. Likewise, Shannon testified that Wyer Dick's estimate of the savings on the Erie-Lackawanna merger had ultimately been surpassed. The record with respect to the Seaboard Airline-Atlantic Coast Line merger was not quite so clear. However, the impact of the ICC report relied upon by the GPs, in which the ICC reduced Wyer Dick's estimate of annual consolidation savings by 50 percent, *Seaboard Airline R. Co.-Merger-Atlantic Coast Line,* 320 I.C.C. 122, 154-59, *supra*, was effectively blunted when EL brought out that the Commission's refusal to take account of some of Wyer Dick's estimated savings did not concern consolidation savings but rather savings from abandonments for which the carrier had ultimately decided not to seek authority. *Id.* Except for these the Commission noted that "most of the prospective savings appear to be fairly realistic and generally attainable". *Id.* at 156.302.

We do not say that an acquirer of EL would have accepted Shannon's estimate of consolidation savings at [illegible] value, to be taken as the word of God without debate. Very likely, in the real world, an acquirer would have attempted to make its own estimates if EL had been willing to cooperate and time permitted.[303] Consolidation savings, like everything else in the estimates, would have been a subject of bargaining. What we do conclude is that a purchaser would have regarded Shannon's findings as a reasonable estimate of consolidation savings.

Appendix H

Before leaving the general subject of EL's revenue and expense studies and turning to two other important aspects of EL's case, we think it desirable to emphasize one factor that gives us considerable confidence in Shannon's results. This is the number of positive factors that Shannon did not seek to quantify and include in his pro forma statements. He listed twelve of these, Shannon (S) (EL) (Dec. 31, 1978) at 71; we quote only the first seven:

> (1) Traffic the acquirer would lose if EL and the other bankrupts were shut down;
>
> (2) Traffic the acquirer would lose if the acquirer did not acquire EL, or a comparable Penn Central line, and competitors of the acquirer made such acquisitions;
>
> (3) In the case of the Western line acquisitions, traffic diversions from other carriers to either the lines acquired or the lines of the acquirer or both;
>
> (4) In the case of the Chessie acquisitions, diversions of existing Chessie interchange traffic with lines other than the acquired lines;
>
> (5) In the case of the Chessie acquisitions, the benefits to Chessie of possibly withdrawing from Canada;
>
> (6) Reductions in EL and EL-LV car hire deficits resulting from investment in additional freight cars, improved utilization, and increased length of haul;
>
> (7) Net revenue gains on traffic formerly handled by Penn Central but rerouted over EL and LV because of Penn Central's projected abandonments; . . .

Item (6) is of particular importance. It was a recognition of this problem, it will be recalled, see p. 254 & n.282, *supra,* that attracted Darling's attention to El and led him to make his study for Santa Fe. El amplified these points in its opening freight

brief, 1 ELF at 109-14, and we find no sufficient answer to them in the GPs' reply.

3. *The Addition of $100,000,000 to Reflect a Grant by the State of New York*

EL contends that the price payable for its freight lines for continued rail use should reflect a $100 million grant that the State of New York allegedly would have been willing to give to a purchaser in order to assure the continuation of El's freight service across the Southern tier of that State. Its witness, Shannon, included the $100 million in his first year's projected cash flow. Shannon (S) (EL) (Dec. 31, 1978) App. 1B, 2B, 3B, 4B. Although EL's contention was made in the context of attempting to "bridge the gap" between the capitalized earnings of the various EL or El-LV proposals and the higher net salvage value claimed by El, El urges more generally that a purchaser on a capitalized earnings basis would bid higher if part of its payment would be financed by a third party without cost to it.

Mere statement of the argument reveals its legal difficulties. EL is seeking, in effect, to have the prospect of financial aid from a state to a purchaser considered as property of the seller within the scope of the just compensation clause. It seems questionable from a constitutional standpoint whether a state's display of generosity can increase the bill of the United States in a federal condemnation. Beyond this since New York's payment, as recognized by EL's witness Young, Young (D) (July 19, 1979) at 161-62, 21 GP Supp. App. at 739-40, would be for the "social value" of EL's rail service in New York, it is arguable that recognition of the grant as enhancing the purchase price would violate the rule that value to the taker is not a proper element for consideration. We find it unnecessary to answer these intriguing legal questions, however, since analysis of the facts shows that New York's offer was by no means so unequivocal as El contends. *Cf.* note 220, *supra*.

Appendix H

El's case rests on the testimony of its witness, Louis Rossi, Director of the Railroad Division of the New York State Department of Transportation. This must be considered along with the testimony of GP witness Raymond Schuler, who at the relevant period was New York Commissioner of Transportation and thus Rossi's superior.

Rossi was Vice Chairman of a task force which New York created in 1972 to deal with the developing rail crisis. Prior to the discussions leading to the Rail Act, the task force was discussing with profitable railroads the possibility that they might acquire with state assistance the two principal lines across New York, PC's (formerly New York Central's) water level route and EL's route across the Southern Tier, both of which the State deemed essential. The prospect of a federal solution, beginning early in 1973, put a temporary stop to these discussions. However, the possibility that New York might make some contribution to preserving the Southern Tier route was renewed when the El reorganization court decided in 1974 that EL should not be reorganized under the Rail Act, *In re Erie Lackawanna Ry.*, 393 F.Supp. 352 (N.D. Ohio 1974), a decision that was not appealed to this court. The task force opposed a plan of the EL Trustees to improve EL's Scranton line and to single-track and downgrade the Port Jervis line. A principal reason for this position was the belief that the Port Jervis line was essential to a reopening of the Maybrook gateway and rebuilding of the Poughkeepsie Bridge so as to permit competitive service between the west and New England, and also with New York City by land rather than by car float. Since the Port Jervis line alone would be inadequate, the task force advocated use of the LV line from Waverly and abandonment of EL's Scranton line. Rossi (S) (Dec. 31, 1978) at 4.

On April 1, 1974, Governor Malcolm Wilson approved the Rail Preservation Bond Act of 1974, 1974 N.Y. Laws, c. 118, N.Y. Transp. Law App. 6. The Act provided for a funded $30 million essential rail services preservation program and a $250 million bond sale, subject to approval by a referendum, which was

obtained in the November elections. Later the legislature appropriated $107,500,000 of these funds, $62.5 million of which was for the improvement of upstate freight services. Rossi (D) (Mar. 9, 1979) at 92, El App. A at 154.

In April 1975 the task force made known to USRA New York's willingness to offer substantial financial inducements to profitable railroads to acquire EL's Southern Tier route. Rossi (S) (Dec. 31, 1978) Ex. 6. It also renewed its earlier contacts with potential acquirers of the Southern Tier route, particularly Chessie. Chessie's first concern was with state and local property taxes. It wished to be sure that the 80 percent reduction that had been available to EL because of poor earnings would also be available to it; legislation to that end was adopted, Rossi (S) (Dec. 31, 1978) at 7. Chessie also wished exemption from the remaining 20 percent, and Southern Tier mayors and legislative leaders agreed to support this. *Id.* Finally, according to Rossi, "we made clear that the State had available under the Rail Preservation Bond Act substantial funds to facilitate acquisition of the Southern Tier route", which "would have been in the form of grants and could have been used for acquisition costs as well as rehabilitation". *Id.* Rossi asserted that "[o]n several occasions we specifically offered up to $50 million if Chessie were to make the acquisition proposed in the Final System Plan and an additional $50 million if Chessie were to gain access to New York City". *Id.*[304]

Schuler's testimony has a quite different flavor. While not denying that New York might have furnished financial aid to an acquirer of EL's Southern Tier line, he stated that he did not consider making a direct grant of $100 million, or any other amount, to finance acquisition costs. Schuler (S) (Nov. 1, 1979) at 25-26. Rather, any moneys advanced would have been for "a program of projects and *not* a direct grant for acquisition". *Id.* at 25. These advances might have been traditional loans, loans repayable out of revenues generated by the project, or outright grants. *Id.* at 26. Whatever the form, "we would have

insisted that the Port Jervis line remain as a main east-west freight line and that the projects to be financed were to supplement and not to substitute for the basic maintenance and rehabilitation that a purchaser would have undertaken on its own."[305] Insofar as the testimony of the two witnesses differs, we must follow that of Schuler, who was Rossi's superior and would have had to approve any action taken.

EL has attributed to the State of New York a certainty that was not there. There was no guarantee that New York would supply $100,000,000 or even $50,000,000, see note 304, *supra,* to a purchaser of EL's line through the Southern Tier. The most that can be said is that an acquirer of that line could have looked forward to a warm reception from New York's Department of Transportation and could have expected favorable treatment if it sought financial aid for new capital projects in the State. This is a far cry from EL's argument that, because of a New York "grant", an acquirer would have bid $100 million more than it otherwise would. We thus have no occasion to address the legal problems listed at the outset of this discussion.

4. *Consequences to the EL-LV Earnings Case of Our Rejection of the Joint Terminals Concept*

Our holding that public bodies would not have purchased the EL's and LV's JT properties does not necessarily entail rejection of their earnings cases. As already noted, both EL and LV submitted evidence that assumed that private acquirers would have purchased their properties in NJ/NYTerm. EL, for example, claimed that the value of its properties alone to a Western acquirer would have been $225 million, Young (S) (Dec. 31, 1978) at 22, and LV, assuming an acquisition by a large Eastern carrier, claimed a value of $75 million for its lines. LV at 56. Moreover, EL and LV witnesses testified that the viability of a combined EL-LV configuration would not have been dependent on the existence of the NJ/NY Terminal. Shannon (S) (EL)

(Dec. 31, 1978) at 39-40; Adik (S) (EL) (Dec. 31, 1978) at 8, and the two Ts have so contended in their briefs and arguments.

This leads, however, to another problem. EL's evidentiary submission did not explicitly calculate the earnings value of an EL-LV combination based on the assumption that the purchaser would have acquired the EL's and LV's lines in the NJ/NYTerm in addition to their main freight lines (hereinafter the EL-LV without JT). In its June 1, 1981 Statement, EL did give a rough indication of the earning power of an EL-LV without JT proffer. The EL calculated that "annual traffic study net operating income" would increase by $6,777,000 in the case of a Western line, and by $6,748,000 in the case of a Chessie acquisition of EL-LV. These figures do not account for rehabilitation costs. The EL claimed that the asking price for the EL-LV would have increased by $78 million if their JT properties were included. This figure is based on the claimed salvage value of the EL-LV properties in the JT rather than on the capitalized value of the increase in earnings attributed to the EL-LV without JT proffer. Statement of the Erie Lackawanna Trustees in Response to the Court's May 21, 1981, Memorandum (June 1, 1981) at 8-9. Sp. Ct. Rep. at N 35807-08.

In a letter to the parties dated June 19, 1981, Sp. Ct. Rep. at N 36204, the court requested EL to give a detailed breakdown of the projected earnings and cash flows of the EL-LV without JT proffer including the costs of rehabilitation. This statement shows that, including rehabilitation expenses as projected by EL's and LV's witnesses, the net gain to the acquirer of the EL-LV without JT combination would be roughly $4,000,000 annually.[306]

In response to the EL's filing, the GPs take the position that the court should be "loathe" to rely on the EL's new figures. They first contend that:

> The transferors' submissions implicitly and explicitly advance many entirely new factual contentions which are not subject to judicial notice. They are not supported by

> any testifying witness, nor have they been subjected to cross-examination or to evidentiary rebuttal. . . . It would thus be unfair for the Court to rely importantly on [these] new contentions. . . .

Government Parties' Response to July 10, 1981, Filings of EL and R Regarding Earnings Values Without JTs, (July 24, 1981) at 20-21. Sp. Ct. Rep. at N 36364-65.

The court finds little support for this argument. First, as has already been noted, the idea of an EL-LV without JT configuration did not come out of thin air — two EL witnesses discussed this configuration in their statements. What did not appear in those statements are numerical estimates of the earnings power of the EL-LV without JT proffers. But a review of the workpapers underlying EL's July 10, 1981, submission readily reveals that the calculation of the earnings value of the EL-LV without JT configuration was a straightforward development of figures that are in the record and which have already been subjected to discovery, cross-examination, and rebuttal testimony. For example, the key component in EL's analysis is the substitution of EL's and LV's own operating costs in the JT area for those derived in the JTs study. EL's and LV's own operating costs were taken directly from Jennison's studies of the independent proffers. The GPs had ample opportunity to challenge these figures.[307]

What admittedly is different in the EL-LV without JT case is the way in which the figures in the record were used. But, again, we do not think that the GPs were prejudiced by this case. Given that the court believes that an EL-LV without JT acquisition would have been the most likely outcome in the alternative scenario and that all of the numbers that the court would have needed to adjust the EL-LV with JT acquisition to eliminate the effects of exclusion of EL's and LV's JT freight properties can be found in the record, there is no reason why the court could not have taken it upon itself to attempt to make the appropriate adjustments. If the court had chosen this course, it would still have had to rely on

the parties to provide it with information from the workpapers. Undoubtedly, we would have heard objections, either from the GPs, EL-LV, or both, that the court erred in its calculations. Rather than pursue this course, the court chose to seek the aid of the parties in its calculations. We cannot see how the GPs can legitimately complain that they were prejudiced by this procedure.[308]

Apart from attacking the propriety of our considering the EL-LV without JT configuration, the GPs also argue that EL's contention is, as a matter of fact, simply implausible. At the heart of EL's claim that the earnings value of the EL-LV without JT proffer would be greater than that with NJ/NYTerm is evidence showing the EL's and LV's own historic costs of handling traffic in the terminal areas were lower than the costs projected in the JTs study.[309] Yet, as the GPs point out, the entire purpose of the JTs was to achieve major savings through the consolidation of redundant facilities. Citing a 1973 PC report that concluded that "terminals will continue to be a major expense and a major operating headache" and that relief could only come from the expenditure of "massive funds" and the rearrangement of facilities, the GPs state that "[t]he transferor's contention now that unconsolidated operations could have been run at (or below) the costs of consolidated terminals is nonsensical", 2 GPRB at L42.

At oral argument counsel for the JTTs attempted to explain this seeming anomaly. First he contended that because the projected JTs costs were based on averages for all of the carriers in the terminal areas and because EL's traffic was of a type that was generally cheaper to handle, when the averages were computed "the Erie came out somewhere on the wrong end of the stick", Tr. at 532-33. He also argued that EL's costs for its non-JT traffic in the EL-LV without JT acquisitions improperly reflected the arguably higher costs in Northern New Jersey because the non-JT traffic costs were calculated on the basis of system-wide average costs, which included the cost of traffic in the North Jersey area. *Id.* at 526-32.

While these two factors certainly could explain the seeming anomaly, the court is reluctant to base its conclusions on what, after all, are speculations. Although we could independently explore the record further to confirm or refute these theories, this would be a most difficult task without the aid of counsel. This does not mean, however, that the total cost figures for the EL-LV without JT acquisition cannot be accepted. Indeed, we think that, subject to a few important exceptions noted in this opinion, we can be rely on them for the simple reason that the total cost figures for the EL-LV without JT acquisitions are derived directly from the system-wide, historical average cost figures calculated by Jennison for EL and LV. Apart from a few problems, which will be discussed later, the GPs give no reason why Jennison's figures cannot be used in this way. Indeed the GPs' major criticism of the entire JTs study — that it is an artificial construct which ignored the historical operations and costs in the JT areas — is a strong argument in favor of using Jennison's figures. Jennison made his calculations directly from actual expenses incurred by EL and LV. And as already discussed, see pp. 262-65, *supra*, we reject the limited criticisms levelled by the GPs at Jennison's study.

The GPs do, however, make one relatively major criticism of the actual calculations contained in EL's July 10 submission. The NJ/NYTerm operating plan provided that CNJ's main line, which previously carried both freight and passenger traffic, would have been dedicated solely to passenger use. CNJ's freight traffic was thus rerouted over the NJ/NYTerm freight lines. Whatever the merits this routing decision may have had assuming that NJ/NYTerm would have been created, when that assumption is abandoned any possible justification disappears. Without a wholesale public acquisition of all of the Ts' Northern New Jersey properties, there is no reason to suppose that a private acquirer of EL-LV would have been able to divert to its own line all the traffic historically carried by CNJ. Accordingly, in a letter to counsel dated September 4, 1981, Sp. Ct. Rep. at N

36853, the court asked the parties to adjust the figures contained in EL's July 10 submission to reflect this.[310]

B. *Ann Arbor*

As previously stated, Part II, p. 25, *supra*, AA, a 99+ percent owned subsidiary of D,T&I, itself a 99+ percent owned subsidiary of PC, as operated in 1973, extended from Toledo, Ohio, in a generally northwest direction, to Ann Arbor, Michigan, and thence across Michigan to Frankfort on Lake Michigan, where car ferries were operated to Manitowoc and Kewaunee, Wisconsin.[311] The 54-mile Toledo-Ann Arbor segment (sometimes hereafter "the segment") was believed to be profitable, the balance of the line to be a producer of deficits.

The FSP designated the Toledo-Ann Arbor segment[312] to Conrail and an 86.5-mile stretch of line between Durand and Ashley, Michigan, to the Grand Trunk Western. The balance of the AA was not then designated for conveyance.

Prior to promulgation of the FSP an Inter-Agency Task Force appointed by the Governor of Michigan in May 1973 had expressed concern in a report dated January 2, 1975, over expected loss of rail service as a result of pending abandonments and the proposals with respect to AA probable in the FSP, and had advocated the State's assuming a positive attitude. The report recommended that main lines such as AA's should be considered the backbone of the State's railroad system and expressed concern that the expected designation of the Toledo-Ann Arbor segment to Conrail in the FSP would preclude the State's using profits from that segment to cross-subsidize the losing line north of Ann Arbor. The report led the Michigan legislature of 1975 to adopt a number of statutes giving the State extensive power to purchase and operate railroads.

Among the 1976 amendments to the Rail Act was a provision, § 208(d)(2), authorizing USRA, upon petition of any State, to make further designations under the FSP for conveyance, *inter*

alia, to a State. On February 11, 1976, Michigan petitioned USRA to redesignate all of AA's properties for conveyance to the State. USRA granted this petition to the extent of redesignating the Toledo-Ann Arbor segment to Michigan instead of Conrail and also designating to the State the segment between Ashley and Cadillac. USRA also adopted a resolution recommending that the Grand Trunk Western grant trackage rights to the State over the segment designated to it, see *Michigan Interstate Co.* v. *Grand Trunk Railroad Company*, 459 F.Supp. 1008, 1010 n.2 (Sp. Ct. RRRA 1978). In 1980 Michigan purchased all of AA's remaining properties.

The trustee of AA claims that Michigan would have purchased the Toledo-Ann Arbor segment for $9,690,193. Although this figure must be subjected to downward adjustment, we conclude that the Toledo-Ann Arbor segment would have had substantial capitalized earnings value to at least two railroads and would have been purchased in the absence of the Rail Act either by the State of Michigan or by one of the two railroads at a price slightly higher than the lower of the two capitalized earnings values.

1. *The Position of the State of Michigan*

Although in our view it does not particularly matter whether the purchaser of the segment would have been the State or a railroad, we begin by discussing arguments of the GPs that the State would not have been an acquirer. We have thought it preferable to treat this separately from our general discussion of public body purchases, Part XI, because the situation differs in a number of important ways. First, only freight lines are at issue. Second, since AA's earnings value studies for its allegedly profitable Ann Arbor-Toledo segment did not include any traffic originating on the unprofitable northern segment, the GPs' arguments we accepted in concluding that the JTs' freight lines would not have been purchased by public bodies and that prices paid for passenger lines would reflect deductions for the earnings those

lines contributed to the privately acquired lines are inapplicable.[313] Third, AA claims no premium in excess of X for its conveyed Ashley-Cadillac segment. Finally, as will appear, there would have been a number of railroads that would have bid for AA's Ann Arbor-Toledo segment. As a result, all we need here consider is whether Michigan would have had the inclination and financial capacity to purchase AA's Ann Arbor-Toledo segment or, perhaps, since Michigan's interest lay in the preservation of the whole of Ann Arbor, the entire Ann Arbor rail line, in the absence of the Rail Act.[314]

Relatively little evidence on the position of the State of Michigan in the absence of the Rail Act was or perhaps could be offered by either party. The bulk of AA's argument is based upon what actually transpired in the presence of the Rail Act, under which Michigan ultimately acquired AA's entire system. In the absence of the Rail Act, Michigan also would have been concerned about the future of PC's lines in the State. On the other hand, acquisition of the Ann Arbor-Toledo segment in the alternative scenario would have been at a price AA contends to be substantially higher than the actual price paid by the State under the Rail Act, and the purchase would have had to have been effected without federal assistance that explicitly was part of the federal response to the rail crisis. See 2 GPRB at Q 5 n.7 (use of federal assistance in State's purchase); pp. 216-17, *supra*, (limits upon consideration of federal finance). Also, the profits from the southern segment would not have been available to cover losses on the rest of the system if Michigan, rather than obtaining the southern segment at a bargain price under the Rail Act, would have had to pay the full capitalized earnings value to avoid its acquisition by prospective solvent acquirers.[315]

The GPs are probably correct in arguing that Michigan would not have acquired the entire AA unless there were no alternatives. 4 GP at R 165-66. But, aside from the argument that the ICC would have conditioned the sale of the southern segment upon inclusion of part or all of the lines to the north, a question we have

above decided in the negative, Part X, pp. 188-91, *supra*, the GPs indicate no other possible acquirer of the northern lines. Michigan's efforts in the presence of the Rail Act to get Conrail or solvent railroads to bear the burden, 4 GP at R 167-72, are hardly surprising but are not necessarily indicative of what Michigan's actions would have been in the absence of the Rail Act. The State's unwillingness to acquire or operate rail lines prior to enactment of the Rail Act, 4 GP at R 174-75, is likewise not probative since this does not indicate its probable response when faced with a rail crisis. After all, Michigan did enact legislation permitting acquisition and operation of railroads when confronted with the possibility that lines in the State would not be included in Conrail, AA at 6-16, and its study of the State's railroad network and prospective abandonments began in June 1973, prior to enactment of the Rail Act. Petition for the Amendment of the Final System Plan, VII 17 at 2. The importance of the AA to the state was adequately documented. See *id.* at 5-11. Our review of these material indicates to us an attitude toward the State's acquisition of AA entirely different from that of the northeastern states whose heavy financial involvement in supporting commuter traffic made them allergic to further expenditures for freight lines, whether for capital or operating expenses, see Part XI, p. 204, *supra*.[316]

Michigan's financial capacity is not seriously questioned. AA claims that the Motor Vehicle Highway Fund would have been available, for example, by using it to retire special obligation indebtedness, which, by contrast to general obligation bonds, did not require electoral approval. The GPs correctly indicate that the Motor Vehicle Highway Fund was to "be used exclusively for highway purposes as defined by law". Mich. Const. 1963, Art. 9, § 9. But in 1977, the Michigan Supreme Court upheld the legislature's definition of "highway purposes" as including the acquisition of rail properties. *Advisory Opinion on Constitutionality of 1976 PA 295 and 297*, 401 Mich. 686, 707, 259 N.W.2d 129, 137

(1977). There is no reason to doubt that the legislature's definition would have been accepted by the same court in the absence of the Rail Act. In any event, the GPs offer no persuasive evidence suggesting that Michigan would have been unable to raise the necessary funds from any of a number of traditional revenue sources.[317]

We thus conclude, although again emphasizing that the issue is not of real importance, that Michigan would have sought to acquire the Ann Arbor-Toledo segment and, indeed, the whole of AA.

2. *Competitive Bidding*

Shannon, testifying as a witness for AA, considered D,T&I as the most likely railroad to have acquired the Ann Arbor-Toledo segment. The primary reason he gave was that the acquisition would have afforded D,T&I an improved route into Toledo, which, despite its name, it did not reach directly but only by trackage rights. Shannon (S) (AA) (Dec. 31, 1978) at 4. However, as the discussion of off-segment revenues developed, improved access of D,T&I to Toledo emerged as a rather minor factor; the important point became that if the Ann Arbor-Toledo segment were acquired by another railroad, D,T&I would have been subjected to substantial traffic diversion. When AA was under D,T&I control, traffic was routed to give the maximum haul over the AA-D,T&I system even if this shorthauled AA. A solvent railroad purchasing of AA's Ann Arbor-Toledo segment would have followed the same policy of obtaining the long haul for its own combined operation, with serious adverse consequences to D,T&I.[318]

The GPs make several answers to the claim that D,T&I would have been a bidder, but we do not find these persuasive. One is the testimony of the AA Trustee that when D,T&I placed AA in bankruptcy, a D,T&I official stated that "they had put their last penny in the Ann Arbor and they were not going to take any

further bath." Chase (D) (June 29, 1979) at 9, 9 GP Supp. App. at 509. This testimony, however, related to what D,T&I would do for AA as a system, subject to the claims of creditors, not to what it would do by way of acquiring the Toledo Ann-Arbor segment free of debt, particularly if it were faced with prospects of the latter's abandonment or sale to a competitor. As we shall see later, a purchaser of all the IFLs or an acquirer of the Detroit-Cincinnati IFL, which might be Southern, Louisville & Nashville, Chessie, or Norfolk & Western, Shannon (S) (PC) at 36-37,[319] or Norfolk & Western even if it did not acquire the Detroit-Cincinnati IFL, Shannon (AA) (S) at 4, would have been possible acquirers.

The GPs' third ground for attacking the premise that D,T&I would have feared diversion is that "carriers cannot dictate routings". Sullivan (S) (Traffic on the AA) (Nov. 1, 1979) at 5. While it is true that if a shipper explicitly directs that his traffic be transported over an established through route, the carrier is legally obligated to follow the shipper's instructions, 49 U.S.C. § 10763, AA argues convincingly that the carrier serving a shipper's plant is peculiarly able to influence the shipper, assuming cost and service are equal, to route traffic so as to give that carrier the long haul or leave the routing to the carrier, which would have the same result, AA at 61-65.[320] Doing this costs the shipper nothing and enhances the carrier's zeal to give good service and respond to complaints.[321] It is true that an acquiring carrier will not ordinarily be able to divert 100 percent of the traffic susceptible to diversion, but D,T&I would have been sufficiently disturbed over the threat of substantial diversion to wish to keep the Ann Arbor-Toledo segment for itself.

AA also made a convincing case that there would have been at least one other bidder, namely, an acquirer of one of PC's IFLs. We deal initially with the GPs' claim that it is impermissible for us to consider the acquirer of any or all the IFLs as a potential bidder since there is no assurance that any of the IFLs would have been acquired. Apart from the considerations set forth in Part

III of this opinion relating to the GPs' refusal to take a stand with respect to the continuance of any IFL in rail use, see pp. 28-29, *supra*, we believe there is sufficient evidence in the record to show, at least in the absence of contradictory proof by the GPs, that the IFLs would have remained in service, although they might not necessarily have commanded the prices proposed by PC. In addition to the general statements by James McClellan, USRA's former Director of Strategic Planning; Frank Barnett, former Chief Executive Officer of Union Pacific and a vigorous sponsor of the Rail Act; USRA's consultants, Temple, Barker & Sloane; and the Rail Services Planning Office of the ICC, see AARB at 15-17, the evidence presented by PC, notably the testimony of witnesses Hallingby, Jennison, and Myers, sufficed in the present context to meet the burden imposed on page 5 of our order of December 5, 1980, immediately after PC's settlement, that "to the extent that any of [the Ts'] proposals for continued operation of their own lines hinge on continued operation of lines of PC, they have the burden of showing that such lines would in fact have continued in rail use". Sp. Ct. Rep. at 23424.

When we turn to the facts, we find that such difficulties as AA faces are largely semantic. AA witness Laurie[322] said in his initial statement:

> Penn Central was recognized as a likely purchaser of the segment by reason of its Chicago-Detroit route, Detroit-Cincinnati route, and its interchanges with the Ann Arbor at Toledo and at the City of Ann Arbor. Although a sale of the Penn Central system to a single buyer assuming no Rail Act would have been extremely doubtful, I nevertheless concur with Mr. Charles Shannon's testimony that a buyer of the Detroit-Chicago route or the Detroit-Cincinnati route or both would indeed have been a likely purchaser of the Toledo to Ann Arbor segment.

Laurie (S) (AA) (Dec. 31, 1978) at 2. The difficulty springs from the reference to the Chicago-Detroit route. Although acquisition of AA by an acquirer of that route alone presumably would have afforded some opportunity to divert traffic between points on the Ann Arbor-Toledo segment and the west which AA had interchanged with Norfolk & Western at Milan, Michigan, apparently the bulk of the diversion would have been of southbound traffic previously exchanged with D,T&I at Diann, see note 318, and would have enured to the benefit of IFL lines east of Toledo to Potomac Yard; an acquirer of the Chicago-Detroit IFL would have derived no benefit from this although the assumed acquirer of all the IFLs would have.

In his rebuttal testimony, Laurie submitted a Study of Southern Railway Acquisition of the Toledo-Ann Arbor Segment of the Ann Arbor Railroad Company. Laurie (S) (Oct. 15, 1980) Ex. 5. In an introductory section he explained that since his earlier report, which had assumed acquisition of all the IFLs by a single purchaser, "it has been determined that PC's scenario contemplates segmentizing that railroad for sale to various potential purchasers." He chose for study the Detroit-Toledo-Cincinnati "zone"; assumed that, as Shannon had testified, Shannon (S) (PC) (Dec. 1, 1978) at 36-37, Southern would have been a likely purchaser of that "zone", and further assumed that, having made that purchase, Southern would have been a bidder for the Ann Arbor-Toledo segment.[322] This showed even higher earnings than the study made on the assumption that the bidder would have been a single acquirer of all the IFLs since in the Southern study, off-segment revenues included not only those on the acquired IFL, as had been the case with his initial study, but on Southern's own lines south of Cincinnati.

We thus conclude that, assuming for the time being the correctness of Laurie's figures, there would have been two railroad bidders for the segment and that Michigan would have had to pay somewhat more than the lower of the two capitalized earnings values.

This last statement warrants elaboration. It is clear, from what has been said in Part V, that if two railroads were the only bidders for a T, the road to which the T would be more valuable would need to bid only somewhat more than the other; hence the lower of the two capitalized earnings values determines the outcome. AA seems to argue that its case is different because there were three potential bidders, not two. If the third bidder were a railroad, AA would be right; the third railroad would have had to bid more than the capitalized earnings value to the higher of the two others, not the lower. But here Michigan had the power to condemn all the Ann Arbor-Toledo segment, except for the few miles between the Ohio-Michigan boundary and Toledo, which AA surely would have been willing to sell at a reasonable price if the rest of the segment were condemned. In a negotiated sale, therefore, Michigan would not have paid more than what it would have had to pay if it resorted to condemnation. See Part XI, pp. 233-37, *supra*. In such a condemnation, the market value would have been only what AA could have obtained from the railroad having the greater interest in the segment and that, as we have shown, would have been only somewhat more than what would have been paid by the next lower.

3. *The Extent to Which Off-Segment Earnings Should be Taken into Account in Determining Capitalized Earnings Value*

Laurie's estimate of the value of the segment to Southern depended heavily on added earnings Southern would achieve on the acquired Detroit-Toledo-Cincinnati IFL and on its own lines from traffic originating or terminating on the segment that had not heretofore moved over these lines. His estimate of the value of the segment to D,T&I depended heavily on the retention of earnings on D,T&I that would be diverted if the segment passed into the hands of a purchaser of all the IFLs. The GPs object to inclusion of such amounts on a number of grounds.

We have already largely disposed of the first of these, namely, that traffic cannot be diverted since routing rests in the control of the shipper. What remains to be determined is what proportion of the divertible traffic would in fact have been diverted. Recognizing that "[t]he assumption that PC could control 100 per cent of the interline competitive traffic may not be entirely realistic", Laurie (S) (AA) (Dec. 31, 1978) Ex. 1 at 5, Laurie's study of the value of AA to a purchaser of all the IFLs made separate estimates on the basis of 100, 90, 85, and 75 percent control. He followed the same course in his Southern study. There was no need for doing this in the D,T&I study since this was based on historic movement of the traffic. AA's translation of the earnings into capitalized value used the 100 percent figure. We have no real basis for choosing among the figures except that we join Laurie in believing that 100 percent is too high. Since some figure must be chosen, we take the most conservative and opt for 75 percent.

The GPs argue also that earnings should never be counted save on the line on which they are earned. This would be true enough if we were dealing with a study of the overall level of railroad earnings or with segregation studies of the sort that figured prominently in railroad reorganizations of the 1940's, since earnings should not be double-counted. However, we see no reason why if a railroad believes that an acquisition will funnel new profitable traffic over its lines, it would not take that profit into account in making a bid. What must be avoided is not counting off-segment earnings but double-counting them.

The GPs assert that the latter has occurred, but we find AA's response convincing. Southern would not have been interested in acquiring the Ann Arbor-Toledo segment unless it was sure it had acquired the Detroit-Cincinnati IFL, for which, as pointed out, it could well have faced competitive bidding from the Louisville & Nashville. In bidding for the Detroit-Cincinnati line, it would not have known whether it would succeed in acquiring the Ann Arbor-Toledo segment since it would have faced bidding from

D,T&I and the State of Michigan. Hence it would have been irrational for Southern to include added earnings from acquisition of the segment in its bid for the Detroit-Cincinnati line.[324] Beyond this Laurie testified in rebuttal, Laurie (S) (Oct. 15, 1980) at 9, that, as suggested by the GPs' witnesses, Allen & Kozu (D) (Aug. 21, 1980) at 1040-41, 1 AA Supp. App. at 37-38, he had contacted PC's valuation witness Wilmot, who advised him that when PC submitted its earnings estimates on December 1, 1978, a month before Laurie's testimony was filed, it had taken no account of any additional traffic that might be received from the Ann Arbor-Toledo segment.[325]

4. *American Motors Jeeps*

Many pages of brief have been devoted to the question whether AA would have continued to receive revenue from jeep traffic from an American Motors plant on Stickney Avenue in Toledo. The jeeps were manufactured at a plant located on Cove Avenue, which was served by PC, but PC's tracks were incapable of handling the type of bi-level cars needed to ship the jeeps. Hence these were trucked to the American Motors parts plant on Stickney Avenue, which was adjacent to AA's southern terminus at Ottawa Yard.

The Stickney Avenue plant was served by six tracks, all set up by AA and to all of which it had access. PC had access to Tracks 5 and 6, but these were suitable only for the delivery of coal to the plant. Tracks 3 and 4 were used for loading boxed jeeps for export and Tracks 1 and 2 were used for loading jeeps aboard bi-level freight cars for domestic shipment.

GPs witness Sullivan testified, Sullivan (S) (Traffic on the AA) (Nov. 1, 1979) at 6-7, that neither a PC acquirer nor D,T&I would have paid for revenues from the Stickney Avenue plant since AA had no control over the traffic and could have lost it at any time. He also said, *id.*, that a PC acquirer could have adjusted its tracks serving the plant so as to give it full access to

Tracks 1 and 2 and serve the jeep traffic. GPs witness Klick added, Klick (S) (Revenues Associated with AA) (Jan. 30, 1980) at 5, that D,T&I could have obtained access to the plant through reciprocal switching over PC if AA went out of business.

AA's broadest answer is that if these changes could be made now, they could have been made years ago but were not,[326] and that this indicates there must have been a good reason for not doing so. It finds the reason in American Motors' desire to have all movements of jeeps at the Stickney Avenue plant under the control of one carrier, to wit, AA. It claims this situation would continue so long as it stayed in business and points out that the GPs have not claimed that the Ann Arbor-Toledo segment had no earnings value. Hence, it argues, American Motors would not have consented to the "adjustment" of the PC tracks, which were located on American Motors' property, or in any way encouraged PC's competition for the jeep traffic.[327] With respect to D,T&I AA calls attention to the limited nature of Klick's testimony, namely, that D,T&I could have obtained access by reciprocal switching over PC's lines if AA had ceased operation, which AA claims would not have happened, and not that D,T&I could have obtained access by reciprocal switching over AA. It also complains about the GPs' failure to introduce the reciprocal switching tariff in evidence, and questions the value of access by D,T&I to the Stickney Avenue plant since D,T&I's only access to Toledo was by trackage rights over AA.

The situation is a confused one, all the more so because of the failure of anyone to call any official of American Motors. The claim that traffic of a particular shipper would be wholly or partly lost to a T that had long handled it, solely because other carriers would increase their efforts to get it, is surely one on which the GPs had the burden of proof. We think they did not carry it.

Appendix H

5. *The Cost of Handling Off-Segment Traffic*

Having determined what off-segment traffic would accrue to an acquirer of the segment, Laurie then had to estimate the costs of handling it. For this he utilized a study prepared by Edward Jennison[328] with respect to acquisition of AA by either a single acquirer of the IFLs or by D,T&I.[329] Based on his judgment, Jennison set figures for variability in the 1973 operating accounts, expenses for net rents, costs of capital (at 8 percent), and taxes of PC and D,T&I. This resulted in a cost-revenue ratio of 75.58 percent, Laurie (S) (AA) (Dec. 31, 1978) Ex. 1, Table 5, Sheet 4, and of 71.68 percent for D,T&I. *Id.* Table 8, sheet 4.[330] In his Southern study, Laurie used the 75.58 percent ratio he had developed for PC for traffic carried on the acquired line north of Cincinnati. Laurie (S) (Oct. 15, 1980) Ex. 5 at 5. However, for the traffic carried on Southern's historic lines he used a figure of 54.56 percent, which was said to "reflect" a special study of the five Class I railroads in the Southern Railway System in 1973. *Id.*

The GPs attack all these percentages as too low, particularly when used to develop earnings that are expected to last forever. They rely not on a detailed criticism of the percentages of variability applied to the particular accounts but to testimony given by the PC's and GPs' opportunity cost witnesses, Kornhauser and Schneider, on the degree to which solvent railroads could recoup revenues lost from PC's abandonment by reducing expenses, including the opinion of some economists that the ratio of long-run variable costs to total costs might be as high as 90-99 percent, which would produce a ratio of long run variable costs to revenue in the range of 85 percent, 3 GP at K 34-36.

In the absence of direct evidence to the contrary, the view that PC could have spread 20,000 added cars of AA traffic over all the IFLs at a ratio of 75.58 percent of added costs to revenues does not seem unreasonable. However, that conclusion does not contribute greatly to a solution since the proffer of a single acquirer

of the IFLs as purchaser of the Ann Arbor-Toledo segment has been withdrawn. With respect to D,T&I, the ratio of the amount of traffic being considered to the railroad's total revenue is, of course, much greater. We would think that on a short run basis, D,T&I would have done exceedingly well to contain the loss of what had been a substantial portion of its traffic to 28.32 percent of revenues. It might have done better in the long run but — apart from Keynes' epigram, which AA refreshingly notes, AARB at 91-92 — long-run savings would be diminished by discount. Also Laurie, in apparent error, failed to take into account that acquisition of the segment by D,T&I would save the latter $168,772 a year in trackage fees, AA at 57 n.2. All things considered, we are not disposed to alter, on the grounds presently under consideration, Laurie's estimate of the capitalized earnings value of the segment to D,T&I.

We have more difficulty with Laurie's estimates with respect to Southern. As a matter of common sense one would suppose that if it would have cost an acquirer of all the IFLs 75.58 percent of added revenues to handle the added traffic produced by the segment, including the long haul of much of the traffic to Potomac Yard, it would have cost an acquirer of the Toledo-Cincinnati IFL a higher percentage of revenues to haul the traffic over that relatively short railroad, with the added traffic constituting a larger proportion of the total. As against this Southern has had a particularly low freight operating ratio, ranking third (on the basis of 1969-73 averages) of the twenty railroads studied by GPs witness Smith, Smith (S) (Jan. 30, 1980) Ex. 17 at 14, with a 1969-73 average of 71.1 percent. On this basis the 75.78 percent figure of added costs to revenues over the Detroit-Cincinnati IFL operated as part of Southern does not seem unreasonable. With respect to the estimate of a 54.56 percent ratio of costs to revenues for added traffic over Southern's own line, the "special study" on which Laurie relied apparently was not produced, but the GPs did not ask that it be. In a sense, moreover, the precise correctness of

Laurie's estimate of earnings for Southern acquisition is immaterial. His estimated capitalized earnings value for this acquisition ranged upward from $11,091,999, assuming a 75 percent degree of control over segment originated or terminated traffic and a 15 percent capitalization rate, Laurie (S) (Oct. 15, 1980) Ex. 5 at 6, as compared with $7,044,280 for acquisition of D,T&I. Laurie (S) (AA) (Dec. 31, 1978) at 11. For reasons heretofore explained, Southern would have had only to top D,T&I's bid.

6. *Use of 1973 Traffic as the Base for Projecting Revenue*

The GPs' opening brief did not directly challenge the propriety of using AA's 1973 traffic as a basis for calculating revenues, except insofar as such a challenge could be inferred from a quotation from a paragraph of the testimony of AA witness Weisman, 3 GP at K 7, that "traffic began to decline again in 1967 and continued to do so for the years thereafter". AA's reply brief is convincing that this testimony referred only to the car ferry traffic, none of which was included in Laurie's estimated revenues, AARB at 77-79.

However, during the cross-examination of AA's rebuttal witnesses, Weisman and Laurie, the GPs introduced, over AA's objection,[331] identical exhibits purporting to show that cement shipments on AA declined substantially from 1973 to 1974 and 1975. In its reply brief, AARB at 80, AA noted that "[a]lthough the Government Parties did not raise the matter at all in their Opening Brief, they may attempt to argue in their reply brief that a decline in traffic would have reduced the amount that a purchaser of the Toledo-Ann Arbor segment would have paid if, as the Government Parties have suggested, the disposition of the segment were to have been delayed several years".

AA's anticipation proved correct; the GPs' reply brief contains several pages, 1 GPRB at I 9-15, dealing with the subject and expanding the argument to include automobile originations from

American Motors' jeep plant, as to which evidence similar to that with respect to the cement shipments had been used in the cross-examination of AA's rebuttal witnesses, and auto parts, mainly from Ford's Salina plant, figures for which had not been presented.[332]

AA objects to consideration of this evidence on a number of grounds. It claims that this material should have been used at the initial cross-examination of Weisman and Laurie, which would have given AA a chance to respond in rebuttal or that, at the least, it should be restricted to Laurie's Southern study which, was the only new earnings material in his rebuttal testimony. It also questions whether the statistics were properly authenticated under F.R.E. 901 and 902.[333]

It surely would have been preferable for the GPs to have made their point on Laurie's initial cross-examination so that AA could have developed explanatory evidence in rebuttal. So far as we can determine, the record contains no figures as to the total traffic on the segment on 1974 as against 1973; for all we know, the drop in cement and auto parts shipments may have been made up by increases in other traffic. Moreover 1974 and 1973 were years of recession, and, AA claims, AARB at 87, that if the contention had been timely raised, it could have proved that shipments increased when the recession ended. All things considered, we are not disposed to give more than slight weight to the GPs' contention.

We thus conclude that D,T&I would have been willing to pay a sum close to Laurie's estimate subject to the downward adjustments noted herein and required by the discussion in Parts VII, VIII, and IX, and that the acquirer of PC's Detroit-Cincinnati segment would have been willing to pay sufficiently more to insure the acquisition.[334]

Appendix H

C. *Lehigh & New England*

We have described the configuration of this small road and the claims of its receiver in Part II H. We now hold that L&NE did not discharge its burden of showing that its Tamaqua branch would have continued in rail use. With respect to its Bethlehem branch, we hold that while this might well have been purchased by Chessie as an acquirer of R's class (a) lines, there is insufficient evidence that Chessie would have faced a competitive bidder. Hence this property also is to be valued at the appropriate version of X.

The sole connection of the Tamaqua branch was with R's Little Schuylkill line. R did not proffer this for continued rail use and classified it as a class (c) line whose future R was unable to predict. It is true, as L&NE argues, that this was not a concession of abandonment on the part of L&NE. However, in its Statement of Position dated May 10, 1978, at 1, Sp. Ct. Rep. at N 10926, L&NE acknowledged that the Tamaqua branch would not have been sold for continued rail use. L&NE had the burden of showing that a connecting line would have existed and did not discharge its burden.

The position with respect to the Bethlehem branch is different. This branch connected with R and LV at Bethlehem, Pennsylvania, and with EL at Bath, Pennsylvania. However, EL's line from Bath to Portland, Pennsylvania, was not designated for conveyance and it connected with a line of EL that would be abandoned in the event of an EL-LV combination. The only possible acquirers thus would have been Chessie as an acquirer of R's class (a) lines and the acquirer of LV.[385] The figures make it plain that neither of these acquirers would have bid for L&NE on the basis of the earnings on the L&NE's own line, which had become negative. The question thus becomes whether L&NE's computation of off-segment revenues is such as to show that competitive bidding would have existed. L&NE witness Storm estimated total off-line revenues of $1,268,434. He assumed the

incremental cost of carrying this traffic would be between 70 and 80 percent. Although in our discussion of AA we have approved recognition of off-segment revenues that could have been diverted (or preserved) through an acquisition, Storm's figures do not show how much off-line revenues that had historically accrued to R could be diverted by a LV acquirer, or vice versa. There was no occasion for him to do so since he cast Chessie as the acquirer of both LV and R. There is thus no record basis for holding that the acquirers of the LV and R would have bid against each other for the purpose of changing L&NE traffic from its historic patterns.

We thus conclude that there would have been no competitive bidding for the Bethlehem branch and that, even if it continued in rail use, the sales price would not have been significantly more than the applicable version of X.

XIII. Central Railroad of New Jersey

CNJ's contentions in this phase of the case are unlike those of any other T. CNJ alleges that, but for the Rail Act, it would have sold its entire rail system to New Jersey for approximately $100 million. It has two ways of reaching that result, however, and it presents what amounts to two separate rail use cases. CNJ's first ("real life") case is unique in this litigation: it attempts to prove a hypothetical sale to the State, based not on speculative contentions about what the State's interests and actions would have been had the Act never been passed, but rather on what the State actually did in the presence of the Act. According to CNJ, it and New Jersey carried on active negotiations that would have resulted in a sale but for the interference of this court in the *180-Day Appeals*, 384 F.Supp. 895. In the event that its "real life" case should fail, however, CNJ has backed it up with a more conventional alternative scenario case—one that assumes that in the absence of the Act the State would have bought CNJ's lines for $100 million.

Appendix H

A. *Central Railroad of New Jersey's "Real Life" Sale to New Jersey*

In 1974 representatives of the State of New Jersey, the federal government, the estate in bankruptcy of CNJ, and some CNJ bondholders discussed on many occasions the prospect of a purchase of some or all of CNJ's properties by the State. According to CNJ, these negotiations made great progress toward an actual agreement during the course of the year, until they were aborted by this court's decision, in the *180-Day Appeals*, that CNJ would be reorganized under the Rail Act. CNJ alleges that, but for that decision, it would have reached accord with New Jersey for a sale of all of CNJ's rail assets for a price in the range of $100 million. Accordingly, CNJ argues, we should assign CNJ a net liquidation value of $100 million, based on an actual, probable sales opportunity foreclosed by the intervention of the Act.

The GPs mount two attacks on this contention, one factual and one legal. Factually, they argue that New Jersey never made any offer or decision to buy CNJ, for $100 million or for any other price. The negotiations CNJ describes, the GPs say, were merely exploratory on the State's part—an attempt to discover the possible size and shape of one among several options open to it. Legally, the GPs contend that even if CNJ's version of the facts is correct, the court should not take cognizance of them because the events in question all occurred in the presence of the Rail Act. The passage of the Act and the resulting infusion of federal activity and money into the Northeast rail system, they argue, must have had a substantial influence on New Jersey's alleged decision to focus its efforts on CNJ. We need not reach the legal issue, however, because we are persuaded by the GPs' factual argument.

CNJ went into bankruptcy in 1967. Its trustee in bankruptcy, R. D. Timpany, who took office in January 1971, was in sporadic communication with New Jersey State officials throughout his

tenure concerning such matters as the State's subsidy of CNJ passenger operations, a possible lease of passenger facilities to the State, and a proposed extension of the Port Authority's operations near Newark. Serious negotiations for a possible State purchase of CNJ did not begin until the election of Brendan Byrne as Governor in November 1973.

The principal negotiator for the State was Alan Sagner, Governor Byrne's Commissioner of Transportation. Sagner spoke or corresponded with Timpany and, separately, with representatives of a committee of bondholders on several occasions in February, March and April 1974. The parties agree, however, that these talks were merely exploratory as to any State purchase. On March 28, Sagner told Jacob Goodstein, a bondholders' representative, that he saw no possibility of a purchase in the immediate future. By April 3, when CNJ's reorganization court held a hearing to determine whether CNJ would be reorganized under the Rail Act or under section 77 of the Bankruptcy Act, the State had decided that it preferred a Rail Act solution. Nevertheless, Sagner continued into early summer to discuss the possibility of a purchase. He met with the bondholders and with the bankruptcy judge, and he requested advice from the Port Authority on how an acquisition might be structured.

In late June 1974, a series of related events set off a small crisis and led to the resumption of active negotiations. CNJ's contract with the State for subsidies on its passenger operations was scheduled to expire on June 30. On June 27, CNJ petitioned USRA for permission to cease all rail operations. The following day the reorganization court issued its decision that CNJ would not be reorganized under the Rail Act. Faced with the possibility of a shutdown of CNJ, Sagner met with Timpany and federal officials to arrange a short-time solution to maintain the status quo while New Jersey and other parties appealed the district court's ruling to this court. The resulting agreement, approved by the district court on July 15, provided for modification of the State's passenger subsidies and for extensive State expenditures to rehabilitate

CNJ's main line. The United States Department of Transportation agreed to provide an additional $3 million advance under § 213 of the Act. In return, CNJ agreed to a stay of the district court's decision, and it agreed to continue passenger and freight operations through November 30, 1979. The parties also agreed to enter into good faith negotiations looking toward a permanent viable solution for CNJ.

Apparently taking this last point to heart, Sagner attended two meetings on July 18. The first, in Washington, was with several federal transportation officials. Sagner mentioned the possibility of a State purchase of CNJ, but pointed out that the transaction would require substantial federal financial help. The federal officials were noncommittal.

The second meeting of the day, in New York, is a key element of CNJ's factual case. Sagner met with several representatives of the bankholders' group to discuss a possible purchase. It was at this meeting that, according to CNJ, Sagner, as New Jersey's Commissioner of Transportation, made an offer to buy the railroad. Timothy Crane, a member of the bondholders' committee, stated, both in a contemporary file memorandum and in later testimony, that Sagner presented a tentative offer to buy all of CNJ's properties, except for three parcels of off-line realty and certain court-controlled accounts. The State would assume an estimated $94 million in obligations and would pay $25 million in cash. The bondholder representatives Crane said, reacted favorably to Sagner's proposal. Crane (S) (Dec. 31, 1978) Ex. 1, CNJ Reply App. at 11. Sagner, by contrast, stated in his file memorandum that the proposal Crane described was in fact presented by Jacob Goodstein, and that Sagner made no commitment on any price. He testified that "what I intended to convey to all of the people involved is that there were no proposals, there were no offers". Sagner (D) (Mar. 21, 1979) at 74, I CNJ App. at 180. Goodstein testified simply that "we discussed a proposed deal" matching the description given by Crane. Goodstein (S) (Dec. 31, 1978) at 7, I CNJ App. at 95.

There are numerous reasons, even in CNJ's own evidence, why we must credit Sagner's recollection of the July 18 meeting over Crane's. On the next day, according to an aide's contemporary memorandum, Sagner told his staff that he was interested in the "possibility" of a State purchase of CNJ, but also considered the possibility that a Conrail solution would be better. Ex CNJ-3, I CNJ App. at 147-49. On July 26, Sagner's office requested two independent valuations of CNJ—one by Sagner's own department, and the other by L. E. Peabody & Associates, a consulting firm. The instructions for the latter study show that Sagner was apparently still undecided as to the form of the transaction (purchase of assets vs. tender offer for bonds),[336] as to whether the State might itself operate the railroad after acquisition, and as to the proper basis for determining the purchase price. At a meeting with Goodstein on July 30 (according to Goodstein's account), Sagner again raised the question of the form of the transaction; he also revealed that he had not yet decided whether off-line realty should be included in a purchase, although he leaned toward exclusion. He raised possible political difficulties if the bondholders were paid in full. Finally, he mentioned that he had commissioned the Peabody valuation study and stated that any proposals he might make would be based on that study. Goodstein (S) (Dec. 31, 1978) at 9, I CNJ App. at 97. As late as August 23, Sagner expressed his expectation that CNJ's net liquidation value,[337] in his opinion, the only proper basis for a price, would be in the range of $70 to $80 million. In the face of this evidence, it is incredible that on July 18 Sagner committed himself, even "tentatively", to a detailed (and unwritten) offer of purchase at a price of $119 million. On the contrary, CNJ's own evidence bears out the inference that, if Sagner raised the "proposed deal" at all, he did so hypothetically in order that he might estimate the bondholders' position.

Of course, it is not necessarily fatal to CNJ's case that no offer was made on July 18, for the record shows that Sagner continued through September to pursue the possibility of purchase. We

have already mentioned his meetings with his own staff on July 19, with the Peabody consultants on July 26, and with Goodstein on July 30. On July 24, he met with Timpany and requested that Timpany propose an offer to sell that Timpany would be willing to submit to the reorganization court. Timpany complied on July 26; his offer proposed a sale, effective on September 1, 1974, of all CNJ properties except court-controlled accounts and three parcels of off-line realty. The State would pay the first $80 million in claims against the estate, plus $25 million in cash less a credit for any reduction the State might procure in claims held by the federal government against CNJ. Timpany (S) (Dec. 31, 1978) Ex. 18. A month later, at an August 23 meeting with federal officials, Sagner reportedly remarked that New Jersey then "contemplated" buying the CNJ and was preparing a bond issue for that purpose. On the other hand, it was at this meeting that Sagner said he expected to pay only $70 to $80 million, and that he learned that he could not obtain any waiver of federal claims against CNJ. Jacoby (S) (Dec. 31, 1978) Ex. 60 at 2. On September 12, Sagner again met with Timpany to review the problem. Sagner expressed concern about paying more than book value for CNJ's assets, but Timpany told him that no data on book value existed. Sagner also asked Timpany's advice on how the State ought to run the railroad if it acquired it. On September 25, Sagner met with USRA officials; they said that a State acquisition was probably better than a market solution, and that partial federal funding might be available under the Rail Act. They pointed out, however, that a federal acquisition was still among USRA's options. Three days later negotiations effectively stopped when this court decided that CNJ should be reorganized under the Act, *180-Day Appeals,* 384 F.Supp. at 954-55, 987-89.

This train of events substantiates CNJ's assertion that, up until that decision, New Jersey had shown great and increasing interest in purchasing CNJ.[338] Despite this, it is far from certain that the State would have actually carried out such a project. On the

contrary, neither Sagner nor any one else in State government was ready to make any final decision on the matter. Although Sagner apparently had Governor Byrne's authority to "explore" the possibility of a purchase, there is no suggestion that he was ever authorized to close a deal, or even to make a tentative proposal. Nor is there any evidence that Sagner or his staff had drawn up any particular plans for acquisition or operation of the railroad. On July 26, Sagner asked the Peabody firm for advice on such basic questions as whether the State should buy freight-only properties in addition to passenger lines, whether it should buy CNJ's nonrail properties, whether New Jersey should operate rail service itself or contract to have private railroads do it, and whether it should make a tender offer for CNJ's publicly held bonds. With the possible exception of the last item, there is no record that Sagner ever reached any decision on these points. Nor did he ever request, let alone receive, any sort of study or estimate of the financial burden the State would incur in operating CNJ—surely a major factor in any decision to buy. It is hardly surprising, then, that Sagner never presented any definite proposal to buy CNJ to the Governor, members of the legislature, the State Attorney General or Treasurer, the Port Authority, the United States Department of Transportation, USRA, or any of the other public agencies that one would expect to participate in such a decision. Moreover there was no consensus, either within Sagner's department or between Sagner and the various CNJ parties, as to an appropriate price.

The existence of substantial uncertainty as to the sale price and properties to be included in the transaction casts further doubt on CNJ's claim that an agreement had nearly been reached. CNJ asserts that the price would have been "in the $100 million range", CNJ at 3, but it appears that that range extended quite far on either side of the mark. We have found ten or more figures in the record, ranging from a low of $70 million to a high of nearly $120 million, representing the proposals, suggestions, predictions, and after-the-fact estimates of the many persons involved as to

what the sale price would be.[339] CNJ's suggested figure of $100 million, then, could be 15 percent too low, or it might be 43 percent too high; there is precious little in the record to tell us where within this $48 million range of possibilities the final result would have fallen. Even that does not reflect the full degree of uncertainty we face. In the first place, there is the problem as to how much of CNJ's property the State would have bought. Perhaps more important is that not all of the many prices mentioned (for example, neither of the proposals by Goodstein or Timpany) can readily be adjusted to exclude the value of CNJ's assets not conveyed to USRA.

In short, although the record suggests that Sagner pursued and probably favored a State purchase, it does not bear out the allegation that New Jersey was on the verge of buying CNJ's entire system. On the contrary, we cannot conclude with any confidence that any State purchase would have occurred at all. There are simply too many unknowns, too many decisions not yet made, too many important actors still absent from the stage, to permit that.

B. *Central Railroad of New Jersey's Alternative Scenario*

CNJ's alternative scenario differs little from the supposed "real life" deal we have just discussed: once again, CNJ alleges a sale of all of its rail properties to New Jersey for $100 million. The most important factual difference between the two sets of contentions concerns timing. According to CNJ, its "real life" sale would have taken place sometime late in 1974. In the absence of the Rail Act, however, CNJ contends that the sale would have occurred a year earlier, in the fall of 1973.

Appendix H

1. *Purchase for Rail Use*

We accept CNJ's contention that, in the absence of the Rail Act, New Jersey would have brought all of CNJ's conveyed properties. CNJ's evidence shows that its commuter lines including the New York & Long Branch Railroad, which CNJ owned jointly with PC, carried 25,000 passengers a day into the New York metropolitan area. New Jersey had already recognized the public importance of this service, providing many millions of dollars in subsidy payments and indirect financial assistance. In 1972 the State had negotiated seriously for a possible lease of CNJ's passenger facilities. CNJ at 28. The State similarly recognized the importance of CNJ's freight service. For example, in 1971, the Commuter Operating Agency found that service "essential", remarking that its loss would be a "serious hardship" to shippers and their employees and communities. Timpany (S) (Dec. 31, 1978) Ex. 6 at 5-6. These State findings were confirmed by a 1971 decision of the United States Secretary of Transportation, Timpany (S) (Dec. 31, 1978) Ex. 3. CNJ served an important function as a sort of state-wide freight terminal carrier. In 1973 it carried 200,000 carloads (mostly originating or terminating traffic), serving some 1,400 customers both on- and off-line. Much of this traffic relied exclusively on CNJ. In the absence of any prospect of private acquisition,[340] then, we find it likely that New Jersey would have intervened to save CNJ's passenger and freight service by purchasing CNJ's rail properties for continued rail use.

The GPs make no attempt to show that any particular CNJ line or facility would not have been acquired. See Part III, p. 25, *supra*. Their main attacks on CNJ's alternative scenario are two that we have already addressed and rejected—the contentions that New Jersey lacked the legal authority and financial capacity to make large rail purchases. The GPs also point out material discrepancies between CNJ's proffer and those of other Ts, especially the JTTs.[341] To point out inconsistencies, however, is not to

resolve them in GPs' favor. In the absence of any evidence that any particular line would not have been acquired, we hold that GPs have not rebutted CNJ's showing that its entire system would have been purchased for rail use.

2. *Timing*

The boldest feature of CNJ's alternative scenario is its assertion that the transaction would have been completed in the fall of 1973. We have already noted the key difficulty in claims of early, independent dispositions: the likelihood that any sale must await the outcome of a comprehensive regional rail planning process. As we said in the *CUE Opinion*, "we think it unlikely that the ICC would have tied its hands early in the proceeding by permitting abandonment or sale of major lines even before it knew what shape the surviving system might take". 439 F.Supp. at 1375. CNJ seeks to escape this mire by arguing that it would have entered the abandonment process so early, and completed its transaction so quickly, that all would have been over before anyone could have seen the need to coordinate CNJ's disposition with those of other bankrupt carriers. We find this contention implausible.

CNJ alleges that it would have been the first T to seek abandonment.[342] CNJ had been in reorganization since 1967, longer than any other T. It had not reported an annual profit since 1957; by 1973, it showed a negative net worth. It was in arrears on interline balances and on scheduled wage increases for its employees. It had already begun disposing of some of its facilities and operations; in 1971-72, it halted its New York harbor lightering operations, its Jersey City coal dumping activities, its entire Pennsylvania freight operation, and its service on several small branch lines. In late 1972 Trustee Timpany staved off the latest of several attempts by the bondholders to force a shutdown of all rail operations. At the same time, however, Timpany

himself petitioned the reorganization court for permission to cancel CNJ's subsidy agreement with the State and to terminate all passenger service if the State would not agree to a more generous subsidy. The district court granted that relief in December 1972, but the Court of Appeals for the Third Circuit, sitting *en banc*, reversed, *In re Central Railroad of New Jersey*, 485 F.2d 208 (3 Cir. 1973), *cert. denied*, 414 U.S. 1131 (1974). In the absence of the Rail Act, according to Timpany, he would have responded to this reversal by filing immediately in the district court for permission to abandon all operations. CNJ contends that this petition would have been virtually unopposed, and would nave been granted with very little delay. Accordingly, New Jersey would have stepped in with an immediate purchase to avoid cessation of service.

We find several serious flaws in this thesis. The first in CNJ's assertion that it would have been the first of the bankrupts to seek liquidation. Indeed, for CNJ to prevail, it must show not only that it would have been the first, but also that it would have led by a margin of at least several months—long enough to allow it substantially to complete its disposition before other parties realized the need for an overall regional solution. CNJ has foreseen our conclusion that PC and other Ts would have filed for abandonment by February 1973, but it contends that this is more a matter of concession by the GPs than of factual proof. CNJ argues that it is entitled, if it can, to show as a matter of fact that the other bankrupts would not have sought to close down in 1973. We need not pass on CNJ's characterization of our conclusions, however, because there is a glaring gap in CNJ's own attempted proof. Although CNJ presents detailed argument as to whether LV, EL, and R would have sought liquidation before CNJ did, it makes no effort at all to show that PC would not have done so.[343] PC was the key to the Northeastern rail problem; it was by far the most important carrier, both in the region as a whole and in New Jersey in particular. In the absence of any evidence, or even any

square allegation, that PC would not have applied for abandonment, we cannot credit CNJ's contention that it would have received authority for abandonment before any other major liquidations commenced.

Even if CNJ would have been the first to seek liquidation, we find no warrant for its contentions concerning the rapidity with which it could have completed the abandonment hearing and the consequent sale to New Jersey. The key to the argument is CNJ's allegation that it could have obtained speedy abandonment authority from the reorganization court without having to go to the ICC or any New Jersey regulatory agency. This seems unlikely in view of the Third Circuit's *en banc* opinion dealing with CNJ's petition to abandon its passenger operations. *In re Central Railroad of New Jersey, supra.* The court applied the requirement of section 77(a) of the then-current Bankruptcy Act, 11 U.S.C. § 205(a)(1970), that a reorganization court may approve a trustee's petition for permission to abandon all or part of a line "only with the approval and authorization of the Commission when required by [the Interstate Commerce Act]". The court held that CNJ, if subject to the ICC's jurisdiction, could not abandon service without ICC approval. 485 F.2d at 211-12. Even absent ICC jurisdiction, the court held, CNJ must seek approval from the Commuter Operating Authority, a State agency. *Id.* at 212-13, citing *Palmer v. Massachusetts*, 308 U.S. 79 (1939). The court rejected CNJ's argument that it was constitutionally entitled to abandon without seeking regulatory approval because of financial erosion. Since CNJ had not even applied to any agency, the court reasoned, it was not allowed to attempt to show that its application would meet undue delay or frustration. The court distinguished *Brooks-Scanlon Co. v. Railroad Commission*, 251 U.S. 396 (1920), and *Railroad Commission v. Eastern Texas R.R.*, 264 U.S. 79 (1924). In *Eastern Texas*, the issue was the carrier's substantive right to abandon, not the procedures it must follow. In *Brooks-Scanlon*, the procedural issue arose as a collateral point, but the Supreme Court

disposed of it by noting that the regulatory agency had already indicated its refusal to grant the requested relief. 251 U.S. at 400. Instead, the *CNJ* court relied on *Palmer v. Massachusetts* to hold that the bankruptcy court could not bypass the administrative agencies. 485 F.2d at 213-15. In the face of this holding, which we approved in the *CUE Opinion*, 439 F.Supp. at 1369, 1372 n.34, it is hard to indulge the assumption that CNJ's reorganization court would have repeated its error by allowing a total abandonment without referring the petition to the ICC and the Commuter Operating Authority.

CNJ tries to evade the Third Circuit's holding by suggesting that its petition to abandon all service have been unopposed in the district court. This is a non sequitur; we cannot assume that the consent of the parties would have led the district judge to disregard his statutory duty. Even granting that point, however, we find CNJ's allegation to be unsupported.

CNJ relies on evidence that purportedly shows that an attorney representing the ICC and the Justice Department conceded the district court's jurisdiction to decide the bondholders' motion in December 1972 to shut down all of CNJ's operations. Timpany (S) (Dec. 31, 1978) at 83-84. From the excerpt CNJ presented, however, it is hard to tell just what the attorney was conceding; he may have meant only that the district court should hear the bondholders' constitutional claims. Moreover, whatever he conceded, he conceded reluctantly; almost in the same breath, he asked the court to delay any shutdown to allow the ICC and other agencies to make alternative service arrangements. It is unlikely that the ICC would continue to concede the court's jurisdiction totally after the Third Circuit's ringing affirmation of the ICC's authority—especially since the need for a comprehensive regional solution could only have become clearer in the intervening months. CNJ also points to the ICC's statement in October 1973 that it was not the proper forum to decide issues of unconstitutional takings. CNJ at 119 n.*. Again, however, that is not a concession of all jurisdiction; rather, it states the obvious point

that the reorganization court retains authority to act in cases of undue delay, frustration, cashlessness, or similar emergencies.

Even had the ICC been as accommodating as CNJ would like, it is improbable that New Jersey would have been the same. The State did fight the district court's decision to bypass the ICC and the Commuter Operating Authority in December 1972; indeed, it was a successful appellant in the Third Circuit's *en banc* reversal of that decision. There are several reasons to suppose that New Jersey would have continued to press the public interest in continued rail service, both before the ICC and in the district court.[344] By September 1973 the State, like the ICC, would have perceived the need for comprehensive planning; even if the ICC had not acted, New Jersey would have sought time to develop its own overall solution within the State. The need for caution would have been multiplied by the lame-duck incumbency of Governor Cahill between his primary defeat in June 1973 and Governor Byrne's inauguration in January 1974. Several witnesses, including Timpany, testified that Cahill's policy was to leave all major policy decisions to the successor administration. 4 GP at P 141-42. Furthermore, even if New Jersey had decided in September 1973 to buy CNJ, it does not follow that it would have agreed to a court order relieving CNJ of its duty to operate. The State surely would not have irrevocably committed itself to a purchase until it had reached agreement on a purchase price—a time-consuming matter. There is no reason why it would have volunteered to accept all interim operating losses during negotiations, if it could have imposed those losses on CNJ's stockholders and creditors by delaying or defeating CNJ's abandonment petition.

The conclusion we reach is that CNJ could not have escaped entanglement in a complex regional planning process.

3. *Price*

All parties agree that any sale of CNJ to New Jersey would have taken place at a price equal to what we have called X. Predictably, however, they disagree as to what X is. Of more immediate importance, they disagree as to what issues we should decide concerning it in this phase of the case. CNJ urges us to decide that the proper measure is "stand-alone" net salvage value, which disregards any possible effect of glut resulting from liquidation of several northeastern railroads at about the same time. That is not all, however; CNJ further urges us to fix an actual dollar amount for its sales price, based on several studies of CNJ done between 1969 and 1974.[345] For reasons developed in Part III of this opinion, we agree with the GPs that these questions must be left for decision in the nonrail use phase of the case.

Petitions for reconsideration may be served and filed on or before 21 days from the filing of this opinion.[346] While it is not setting any page limit, the court requests that such petitions be limited to instances where the court is thought to have misapprehended evidence or to have erred in computations and not repeat arguments that have been made at length in the opening briefs

and reply briefs and in oral argument and have been fully considered. Answers to such petitions shall not be filed unless requested by the court.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

.....

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge

Dated: November 24, 1981

Appendix H

GLOSSARY

AA	Ann Arbor
AAR	Association of American Railroads
AREA	American Railway Engineering Association
AWCC	Average weighted cost of capital
B&M	Boston & Maine Railroad
BTF	Bridge track feet
CERL	Combined Erie, Reading and Lehigh Valley
CMV	Constitutional minimum value
CNJ	Central Railroad of New Jersey
CRA	Charles River Associates
CUE	Compensable unconstitutional erosion
DCF	Discounted cash flow
D,T&I	Detroit, Toledo & Ironton
EBIT	Earnings before interest and taxes
EL	Erie Lackawanna
ELMPA	Erie Lackawanna Merger Protection Agreement
FAHA	Federal Aid Highway Act
FAUS	Federal Aid—Urban System Program
FRA	Federal Railroad Administration
FSP	Final System Plan
GPs	Government Parties
ICC	Interstate Commerce Commission
IFLs	Intercity freight lines
JT	Joint Terminal
JTTs	Joint Terminals Transferors
LIRR	Long Island Railroad
L&NE	Lehigh & New England
LPCs	Labor Protection Costs
LV	Lehigh Valley

MBTA	Massachusetts Bay Transportation Authority
MGT	Millions of gross tons per year
MOWE	Maintenance of way expenses
MTA	Metropolitan Transportation Authority
NEPA	National Environmental Policy Act
NJ/NYTerm	New Jersey/New York Terminal
PC	Penn Central
PCMPA	Penn Central Merger Protection Agreement
PDV	Present discounted value
Philaterm	Philadelphia Terminal
R	Reading
RC	Rehabilitation costs
SEPTA	Southeastern Pennsylvania Transportation Authority
S&P	Sverdrup & Parcel and Associates
TOFC	Trailer on Flat Car
T	Transferor
UMTA	Urban Mass Transportation Act
USRA	United States Railway Association
WJPA	Washington Job Protection Agreement
X	See p. 31 & n.23, *supra*.

Appendix H

FOOTNOTES

1. The phrase was not meant to imply that the GPs had the burden of proof on such issues but rather to refer to issues on which the GPs has been working and could continue to work effectively without having the Ts' direct cases in hand. The parties clearly understood this.

2. This, and other procedural innovations later described, resulted from informal exchanges between the court and its executive attorney, Richard E. Eriksen, Esq., who has rendered invaluable service throughout these proceedings, with the Steering Committees for the Government Parties and the Transferors and Intervenors. After substantial agreement had been reached, the court would issue a show cause order why certain procedures should not be adopted. On the principal procedural innovations, to wit, the submission of direct evidence in writing and the conduct of cross-examination by deposition, there was no objection and an appropriate order was entered.

3. There were remarkably few of these. Most of those requiring judicial action were disposed of by Judge Thomsen, as a single judge, under Rule 4-A of this court.

4. PC's affiliated Ts include 38 wholly owned subsidiaries and 7 with shareholders outside the PC group.

5. The settlement for Pennsylvania-Reading Seashore Lines was approved on January 26, 1981, Sp. Ct. Rep. N 31838; for Dayton Union on February 12, 1981, *id.* N 32113; and for Lehigh & Hudson River and New York & Long Branch on February 26, 1981, *id.* N 32208, N 32214.

6. The settlement for Philadelphia, Germantown & Norristown was approved on October 23, 1981, Sp. Ct. Rep. N 37877, for Delaware & Bound Brook on October 19, 1981, *id.*, at N 37855. The settlement for North Penn had not been approved at the time of publication of this opinion.

7. The proffered Joint Terminals would have included certain properties of the CNJ as well. However, CNJ has studiously avoided any participation in the JT proffer.

8. The route from Chicago through Cleveland and Buffalo to New York was basically the former New York Central "water level" route. The routes from Chicago to Pittsburgh and from St. Louis to Pittsburgh

and Harrisburg were basically the former Pennsylvania Railroad's main lines.

9. Although PC joined in the JT proffer, it was not part of PC's primary case indicating what would have become of its lines in the absence of the Rail Act. The value of some of the IFLs did, however, depend upon the continued viability of freight lines in the terminal areas. See Memorandum on Behalf of PC Concerning JTs Evidentiary Submission (Dec. 15, 1978).

10. For a discussion of EL's use of the term "net salvage value", see note 16, *infra*. While we do not now decide the point, we confess to great difficulty in envisioning a sale to another railroad at "net salvage value" higher than earnings value if earnings value includes all the elements noted in Part V, pp. 40-41, *infra*, of this opinion. We do not believe that EL would disagree.

11. These earnings value figures are derived from a study of LV's value to Conrail rather than its value to hypothesized acquirers.

12. LV contends that, on this hypothesis, its line north from Sayre, Pennsylvania, through Ithaca, New York, to Ludlowville, New York, would have been acquired by shippers with assistance from the State of New York and a public regional corporation.

13. With the exception of 18 miles of LV track in the Geneva-Auburn, New York, area, which connected to PC's "Water Level Route", from Chicago to New York, LV contends that none of its routes are dependent upon the continued existence of any IFLs. LV has also treated these 18 miles of track as "specialized properties".

14. Just prior to scheduling rebuttal evidence, EL, R, and LV moved to exclude from consideration evidence submitted by the GPs indicating what value the "Combined Erie, Reading, and Lehigh Valley" (CERL) would have had to the Chessie on April 1, 1976, Sp. Ct. Rep. N 19316. The Ts included in CERL contended that this evidence was irrelevant to the acquisitions they had proffered, that the GPs had no need to go beyond their directly responsive evidence for the purpose of establishing their claim that the Ts' properties had negative earnings value, and that consideration of the CERL evidence would require much further discovery and cross-examination by them. The court determined that the CERL evidence would not aid it in determining rail use values of the properties of the CERL transferors, and thus ordered that the evidence would not be considered, in the interest of avoiding unnecessary delay.

Order Limiting Rail Use Issues Between the Government Parties and the Erie Lackawanna, Reading and Lehigh Valley Trustees (March 26, 1980), Sp. Ct. Rep. N 19685. The breadth of this order was defined in the parties' Stipulation Regarding Scope of the Order Limiting Rail Use Issues (March 26, 1980), filed on October 24, 1980, Sp. Ct. Rep. N 22028, which specified the portions of testimony to be excluded. See 4 GP at G 1-11.

15. This is subject to the important caveat with respect to the possibility of our having to depart from the "market value" rule under the unique facts of this case expressed in the *CMV Opinion*, 445 F.Supp. at 1030-31, 1045.

16. At least some of the Ts, notably EL, use "net salvage value" in the sense in which that term has been used in ICC abandonment proceedings. However, that does not get us far. EL tells us: Prior to the Rail Act era, no specific ICC rules existed concerning the determination of net salvage value. ELRB at 335. EL also tells us, *id.*, without contradiction, "in practical application it generally came to mean the gross proceeds realizable upon dismantlement of rail lines and the sale of the removed materials (together with real estate, rolling stock, etc.) less the cost of such dismantlement" but without the deduction of other costs (e.g., expenses of a selling organization if needed, and reduction to present value), which the Supreme Court recognized to be appropriate in determining a fair and equitable price for a purchased railroad without earning power in the *New Haven Inclusion Cases*, 339 U.S. 392, 436 (1970), or of "glut", *i.e.*, the temporary presence of an extraordinarily large supply, accompanied by a lessening of demand, due to the assumed nearly simultaneous dismemberment of large portions of the Ts' lines. A petitioner for abandonment is required to include its estimate of net salvage value in its abandonment application. 49 CFR 1121.44(c).

It thus seems that the ICC does not in fact "determine" net salvage value and also that the only significance of its specification by the petitioner is that the ICC customarily conditions approval of abandonments on an agreement of the petitioner to sell for continued rail use at a figure at or above net salvage value. The sole explanation for the omission of commonly recognized deductions in the determination of scrap value which we have found in the record is in the testimony of Shannon on behalf of EL:

> These conventions probably relate to the recognition that a buyer has perceived a rail use value in the line proposed for abandonment. If all possible theoretical deductions were made, the buyer would have paid nothing for the rail use value, since it could itself still liquidate the properties (assuming authority to do so) and receive the same price that it paid.

Shannon (S) (Dec. 31, 1978) at 76.

We confess our inability to understand this explanation. Nothing prevents a purchaser for continued rail use from bargaining for a figure lower than net salvage value, and the petitioner for abandonment would still prefer to accept the offer if it were even nominally more than what the petitioner would receive as scrap value after all proper deductions. Perhaps the answer is that since in small transactions the difference between net salvage value and a more nearly accurate scrap value figure is not likely to be significant, use of net salvage value saves the parties from the expense of protracted investigation and negotiation, and the petitioner's announcement of net salvage value assures a purchaser for continued rail use that a bid in that amount will be accepted unless other acquirers for rail use bid more.

17. This statement should be read with the qualification that we have not made a detailed examination of the massive evidence introduced by PC.

18. The best illustrations are found in EL's case. EL concedes that if its acquirer were to be the Chessie rather than a Western line, EL's main line west of Sterling, Ohio, to Chicago would have been abandoned as duplicative of Chessie's own line and that if its acquirer were to be Norfolk & Western, EL's main line west of Huntington, Indiana, to Chicago would have been abandoned as duplicative of Norfolk & Western's own line. Again, as indicated in Part II, EL and LV urge that LV's line from Waverly, New York, to Oak Island Yard near Newark, New Jersey, was a superior routing to EL's line through Scranton, Pennsylvania, to Croxton Yard near Weehawken, New Jersey; EL concedes that if an acquirer chose the EL-LV combination, the Lackawanna line from Binghamton via Scranton would have been abandoned except that certain eastern portions would have been sold to a public body, presumably the State of New Jersey, primarily for passenger service.

19. We say this despite the statement in our Order upon Motion of the Government Parties for Temporary Suspension of Trial Proceedings

with respect to the Claims of all Transferor Parties other than the Penn Central Corporation (December 5, 1980) at 5, Sp. Ct. Rep. at N 23424, wherein we reminded the Ts "that to the extent that any of their proposals for continued operation hinge on continued operation of lines of PC, they have the burden of showing that such lines would in fact have been continued in rail use through sales to private entities or to public bodies other than the United States rather than being scrapped, although not of showing that PC would have received the price for which it contended". When an adversary declines a specific contest, as the GPs have on the issue here under discussion, the burden on a proponent is relatively slight. See also the discussion with respect to consideration of the acquirer of an IFL as the purchaser of another's railroad, pp. 284-86, *infra*.

20. This position was reiterated by counsel for the GPs at oral argument. Tr. at 412.

21. This avoids the seeming anomaly of pricing non-scrapped property on the basis that it would have been scrapped. The GPs say there is no anomaly since an owner whose property was without significant earnings value is entitled only to its next best use, to wit, sale for scrap, regardless of what in fact happens to the property, and that a purchaser would pay no more. The New Haven was valued primarily on that basis but without objection, *New Haven Inclusion Cases, supra,* 399 U.S. at 436.

22. A prime example is the contention that public bodies would have paid more than net salvage value for losing passenger lines.

23. We choose the letter X rather than "net salvage value" because of the danger that the latter term could mean either salvage value or scrap value, assuming there is a difference between them. In fact, we may find different X's depending on whether a particular property, although without significant earnings value, would or would not be continued in rail use.

24. While we ruled in the *CMV Opinion,* 445 F.Supp. at 1013-16, that in valuing the Ts' properties the United States could not be considered as a prospective taker, we made clear that this did not mean that we must assume that the Government would have simply sat by with its hands folded while the nation moved toward the precipice of economic

collapse, see *id.* at 1008-09 (consideration of interim aid to avoid shutdowns because of cashlessness and regulatory changes permissible in alternative scenario).

25. Shannon, a witness for EL, AA, and PC, is President and Chairman of Wyer, Dick & Co., a transportation consulting firm which for 40 years has specialized in railroad valuation and economics. He has been in the railroad industry since 1936 and has an extensive background in all phases of operations and management. After leaving the New Haven Railroad as Executive Vice President in 1960, he joined Wyer Dick where he has primarily counselled that firm's clients on mergers, acquisitions, and valuation of rail properties. Over the past eighteen years he has been involved in several detailed studies of EL. Shannon (S) (Dec. 31, 1978) at 1-8.

26. The GPs assert that we should discount the value of the Ts' proffered sales for the risk that they might not have materialized. 2 GPRB at Y 20-29. Taking this argument literally would require that we determine values not only for the most likely outcome, but for all possible (nonspeculative) outcomes, weighting each by the probability of its occurrence in the alternative scenario—hardly a feasible approach given the multitude of possible permutations. We think this point can be deferred until we attempt to arrive at definitive figures.

27. We shall use this phrase to include all the properties here at issue although many would generally be regarded as lying in the Midwest. ICC statistics for the Northeast region include New England, the states of Delaware, Virginia, Maryland, Pennsylvania, New York, and New Jersey, and the District of Columbia.

28. Kornhauser is Director of the Transportation Program for Princeton University and is an Associate Professor of Civil Engineering at the University. He has published extensively in the field of transportation planning and economics.

29. The most obvious example is savings in overhead through the elimination or curtailment of the acquired line's executives, and legal, accounting, and traffic departments. Obviously elimination of such departments of the seller would somewhat increase the costs of the corresponding departments of the acquirer; only the net decrease constitutes a saving. The GPs insist that buyers would demand a "share" of savings in overhead and would appropriate the entire savings on their

own lines. We think rather that a capitalization of all such savings, if substantiated, would enter into the buyer's reservation price.

Another type of saving would occur when substitution of a superior line of the seller would enable the buyer to downgrade or even abandon lines of its own. An example of this is EL's claim that an acquisition by Chessie would have permitted the latter to rationalize its Chicago to Buffalo service by abandoning its expensive cross-Canada route and to rationalize its Wisconsin to Buffalo route by abandoning its car-ferry operations to Michigan.

30. The parties refer to the latter as "opportunity costs". The most dramatic case would consist of earnings on traffic interchanged by the buyer with the seller which originated or terminated at points on the seller's line not served by any other railroad. Professor Kornhauser distinguished such "lost traffic" from "jeopardized traffic", to wit, traffic that had been handled with the selling railroad and originated or terminated at points served by roads that were continuing in business. He thought this was also significant although incapable of accurate quantification. The jeopardy would arise from the circuity of the new route, inability because of physical limitations (e.g., single tracking) of the alternative carrier to handle the new traffic efficiently, or policies of the alternative carrier to favor other connections.

31. On this point EL argues that the remaining solvent east-west carriers, primarily Chessie and Norfolk & Western, not only would not have afforded service to many points in the east but that many of their lines were unduly circuitous or could not have absorbed the added volume of traffic previously carried by the bankrupts.

32. We shall follow the parties in calling these off-segment earnings. For example, if Santa Fe acquired EL it could divert to its own lines west of Chicago a certain amount of traffic originating or terminating at points on EL which EL had previously exchanged with other Western carriers at the Chicago gateway. As against this, other Western carriers acquiring other eastern lines such as PC's water-level route from Chicago to New York or its route from Chicago to Pittsburgh and thence to Harrisburg, and on to Philadelphia and New York, could have diverted to themselves certain traffic that these Eastern lines had previously exchanged at Chicago with Santa Fe. EL regarded the balancing of these pluses and minuses as so speculative that it did not take this sort of diverted traffic into account in its revenue estimates for a Western line

acquisition. On the other hand, in its estimates for a Chessie acquisition it did consider the value of revenues on EL's Sterling-Chicago line, which would be abandoned, with the traffic passing to the B&O. We discuss off-segment earnings most extensively in connection with AA, see pp. 286-88, *infra*.

33. The chief example of this was Shannon's claim that creation of one or more transcontinental railroads would have created entirely new rail traffic. Shannon (S) (PC) (Dec. 1, 1978) at 39.

34. Shannon (S) (EL) (Dec. 31, 1978) following 29. This compares with Santa Fe's total pre-tax net income of $144,400,000. Smith (S) (Jan. 30, 1980) Ex. 27 at 8.

35. Kornhauser estimated that the opportunity cost, see note 30, *supra*, to Santa Fe would have been $19,090,000 in 1973 revenues, $7,254,000 in pre-tax profits, and $3,627,000 in after-tax profits if the PC IFLs had ceased operations. In addition, $78,874,000 in revenues would have been jeopardized, see note 30, *supra*, Kornhauser (S) (Dec. 1, 1978) at 50, 53.

36. Numerous witnesses testified to the effect that once a railroad has been shut down, there are serious obstacles to a new start even though the tracks are still in place. See note 263, *infra*.

37. This is indicated by our prophecy that it was the GPs who would doubtless protest the idea of a consortium purchase. Instead they now advocate it.

38. EL agues that § 5(11) immunity would not have been available since the transaction would have been consummated under § 1(18). Passing the point whether the transactions here at issue could have been carried out under § 1(18), which is discussed in Part IX, we doubt whether the Ts would have had sufficient bargaining power to refuse to proceed under § 5 if purchasing railroads had insisted.

39. The GPs have argued that Chessie lacked the resources to finance all the transactions in which it has been named as a potential purchaser. But no one suggested that Chessie would have made all these purchases.

40. In addition to GP witness Jacobs, Shannon, testifying as a PC witness, discussed the possibility of purchases by a consortium but in terms of a consortium bidding against individual lines and having to pay more. Shannon (S) (PC) (Dec. 1, 1978) at 41. Kornhauser also

looked with favor on the idea of a consortium purchase as a means of avoiding uncertainties with respect to existing traffic flows but did not consider the effect of this on price. Kornhauser (S) (Dec. 1, 1978) at 55-58.

41. Murphy is Executive Vice President of the Consulting Center, Inc. Prior to joining that company, he was Vice President of Finance and Operations at USRA and an official with the United States Department of Transportation.

Both Murphy and PC witness Richard Olsen, a senior associate at the consulting firm of Charles River Associates who has an extensive background in transportation economics, developed multiple year cost projections through 1985 which specifically took into account the effects of inflation upon IFL costs and revenues. Murphy concluded that these effects would be distinctly adverse; Olsen concluded that by a combination of rate increases and higher productivity the IFLs would more than meet increased costs due to inflation. We make no attempt to resolve this conflict since no witness attempted to replicate the IFL inflation analysis for the Ts still in this case.

42. In addition Murphy found a 9 month lag between the increase in costs and the implementation of responsive rate increases. This was due to

> a combination of petition lag (the time between incurrence of increased costs and industry submission of a general rate increase petition to the ICC), Commission lag (the time between submission of a rate increase petition and a Commission ruling thereon), and accounting lag (the time between granting by the ICC of a rate increase authorization and implementation of increased rates pursuant thereto by the Railroads).

2 GP at E 103-04 n.58.

43. Testimony to that effect had been given by Shannon, when testifying on behalf of PC before the ICC on the viability of a shrunken PC system. See Shannon (D) (June 21, 1979) Ex. 6.

44. Smith is a Managing Director of The First Boston Corporation, has been involved in financial matters related to the railroad industry for more than a decade, and has had considerable experience in both raising capital and evaluating mergers for his railroad clients.

45. EL also cited testimony of F.L. Lee Jones, a retired First Boston official, that he had made seven merger studies on the basis of constant dollars. 2 ELF at 412 n.352. There was no indication of the nature of Smith's or Jones' constant dollar studies. If these were for the purpose of establishing a fair exchange ratio for stock in mergers, there would be no sound objection to constant dollar studies since inflation presumably would affect both merger partners equally. A study of what a buyer would pay in cash stands differently.

46. EL contends that the same picture exists if the entire period 1966-75 is analyzed. It claims that the historical data showed actual cost increases of $7,473 million as compared with $10,614 million presented in the AAR data and used by Murphy, with cumulative rate increases of $8,229 million—again an excess of rate increases over costs. ELRB at 175.

47. *Ex parte* 256, 332 I.C.C. 280, 287-88 (1968); *Ex parte* 281, 341 I.C.C. 290, 301 (1972); *Ex parte* 305, 349 I.C.C. 862, 873 (1975); *Ex parte* 310, 349 I.C.C. 555, 562-65 (1975).

EL also points out that the rate increase granted in *Ex parte* 310 was $999 million, 349 I.C.C. at 581, rather than the $889 reported by the AAR.

48. *Ex parte 265 & Ex Parte 267*, 339 I.C.C. 125, 177 (1971); *Ex parte* 281, 341 I.C.C. 290, 302 (1972).

49. EL also relied on Murphy's concession that the impact of inflation differs from railroad to railroad. However, we have been pointed to no reason why the Ts here would be less affected than the industry in general.

50. The GPs' witness, Smith, defines DCF as the amount "of cash which would have remained after all of the lines' financial and operating requirements have been met and which, therefore, would have been available either for investment in other projects or, alternatively, for distribution to shareholders as dividends." Smith (S) (Jan. 31, 1979) at 19.

51. To calculate PDV, one multiplies the future payment by a discount factor derived from the interest rate. For example, assume one wants to derive the PDV in year 0 of a DCF of $2 a year realized over a three year period valued at a 10 percent interest rate. The discount factor for the first year is equal to one divided by one plus the interest

rate. To calculate the discount factor for subsequent years one compounds the interest rate. One then multiplies the DCF by the discount factor and sums the results. The figures for the above example would thus be the following:

Year	*Discount Factor*			*DCF($)*		*PDV($)*
1	$\frac{1}{(1+.10)}$	= .91	x	2	=	1.82
2	$\frac{1}{(1+.10)^2}$	= .825	x	2	=	1.65
3	$\frac{1}{(1+.10)^3}$	= .75	x	2	=	1.50
Total						$4.97

52. To capitalize earnings one simply divides EBIT by the interest rate. For example, an enterprise expected to earn $2 a year in perpetuity valued at a 10 percent interest rate would have a capitalized earnings value of $20—$2/.10.

53. See note 44, *supra*.

54. Assume that there are two streams of income expected to be realized over a ten year period. The first stream is a constant one of $100 a year. The second yields $0 a year the first five years and $200 a year in the second five. While both average out to $100 per year, the PDV of the first is greater than that of the second. The higher the interest rate, the greater the difference. Assuming a 15 percent interest rate, the PDV of the two streams (in year 1) would be calculated as follows:

Appendix H

$$PDV = \frac{\$n}{(1+i)n} - 1 \qquad \$n = \text{Payment in year } n$$

i = Interest rate
n = The year

Year	*Stream 1*		*Stream 2*	
1st	100/1.0000 =	100.00	0	
2nd	100/1.1500 =	86.96	0	
3rd	100/1.3225 =	75.61	0	
4th	100/1.5209 =	65.75	0	
5th	100/1.7490 =	57.18	0	
6th	100/2.0114 =	49.72	200/2.0114 =	99.44
7th	100/2.3131 =	43.23	200/2.3131 =	86.46
8th	100/2.6600 =	37.59	200/2.6600 =	75.19
9th	100/3.0590 =	32.69	200/3.0590 =	65.38
10th	100/3.5179 =	28.43	200/3.1579 =	56.85
TOTAL		577.17		383.32

55. This calculation represents a mix of methodologies. To calculate terminal value one divides the normalized year's earnings by the appropriate discount rate—exactly the same as the calculation of capitalized earnings value discussed in note 52, *supra*. Next, one calculates the PDV of the terminal value in the same manner as discussed in note 51, *supra*.

56. In its own study, the LV assumed that its properties would be valued on a tax-free basis. However, in the EL-LV combination, which the court considers to be the more likely outcome, see Part XII, pp. 252-53, *infra*, federal and state taxes are taken into account.

57. Involved in the railroad business since 1929, Laurie eventually became a partner in the transportation consulting firm of Wm. Wyer & Co., the predecessor of Wyer, Dick & Co. Since 1961, Laurie has been an independent transportation consultant. Laurie also submitted evidence on behalf of EL.

58. As a factual matter, it is unlikely that D,T&I would have viewed all future earnings from an AA acquisition as being tax-free. Smith testified that tax loss carryforwards must be used within seven years from the year in which the loss was realized. Smith (D) (Aug. 26, 1980) at 2176, 31 GP Supp. App. at 257. At some point, then, unless

new losses were generated, D,T&I's existing loss carryforwards would have been either used or forfeited. And if D,T&I were to generate new loss carryforwards it obviously would not be in a strong position to acquire any properties. Indeed, AA does not envision any loss carryforwards being generated by D,T&I itself since D,T&I was a profitable railroad. Rather the loss carryforwards come from D,T&I's parent company, PC. But again, if D,T&I expected that at some time in the future PC, as part of its reorganization, would have sold D,T&I, D,T&I would not have expected to remain in a tax-free status forever.

59. See Smith (D) (Aug. 26, 1980) at 2169-71, 2176-78, 31 GP Supp. App. at 254-59. To illustrate, suppose a company is choosing between two investments both yielding $100 a year before tax in perpetuity. Assuming a 10 percent interest rate and a 50 percent marginal tax rate, the market value of both investments would be $500: (.5x $100)/.10. To a tax exempt acquirer, both investments would be worth $1000. If for some reason the price of one investment rose to $600, the company would choose the other investment even though the first investment would still be worth more than $600 to the investor.

60. For a discussion of a proper treatment of depreciation in valuing an enterprise, see Blum & Katz, Depreciation and Enterprise Valuation, 32 U. Chi. L. Rev. 236 (1965).

61. Continuing the above example from note 59, *supra*, if company C had annual earnings after depreciation of $100, depreciation charges of $30 a year, and capital expenditures needed to maintain income of only $20 a year, the capitalized value of the enterprise would be $1000 if one capitalized EBIT and $1100 if one capitalized DCF. Typically, however, both because capital replacement costs usually exceed the capital acquisition costs upon which depreciation is based due to inflation and because the PDV of allowable depreciation charges is less than acquisition costs, capitalized expenditures needed to maintain income are usually greater than depreciation charges, see Blum & Katz, Depreciation and Enterprise Valuation, *supra*.

62. L&NE argues that capital expenditures needed to maintain income are not properly chargeable against earnings since they are more in the nature of retained earnings. See L&NE at 34-35. L&NE misunderstands the GPs' point. The allowance for capital expenditures is not properly deemed retained earnings since there is no net addition to the earning power of the company. These are expenditures which are

needed to maintain the earnings power of the enterprise, not to augment it.

63. Smith also included "additions to working capital" in his calculation of capital expenditures needed to maintain income. This item can safely be ignored, however, since it never exceeds even 1 percent of cashflow for the IFLs. See Jennison (S) (Cost and Revenue Analyses for the IFLs) (Dec. 1, 1978) Scheduled C.

64. Storm is a Vice President of Wyer, Dick & Co. and has been involved in rail transportation during his entire professional career. He was employed by the New York Central and the Port of New York Authority prior to his joining Wyer Dick eleven years ago.

65. Equipment trust certificates are loans secured by a first mortgage against the rolling stock purchased with the proceeds from the loan.

66. From 1931 until his retirement as General Investment Manager in 1972, Young specialized in the analysis of prospective and oversight of previously made railroad investments for his employer, The Prudential Insurance Company, and was personally involved in most of the railroad reorganizations of the 1930's and early 1940's. See Young (S) (Dec. 31, 1978) at 1-2.

67. *Id.* at 11-12. EL posited a July 1, 1974, disposition date. See Part X, *infra*.

68. Actually, Laurie used a "pre-tax" interest rate of 15 percent. Assuming a 50 percent marginal tax rate, this is the same as using a 7.5 percent after-tax rate.

69. Laurie explained only that a 15 percent pre-tax interest rate, the equivalent of a 7.5 percent after-tax rate, is "considered appropriate". Laurie (S) (AA) (Dec. 31, 1978) Ex, AA-JL-1 at 8.

70. Roll is a Professor of Finance at the Graduate School of Management of UCLA. He has published extensively and has served as Associate Editor of several journals in this field. See Roll (S) (Jan. 30, 1980) Ex. 1.

71. Richard Meyer is a Professor of Business Administration at the Harvard Business School where he has taught since 1965. His list of publications is both long and impressive. See Meyer (S) (Jan. 30, 1980) at App. 1.

72. Hallingby is Vice Chairman of Merrill Lynch and is former Chairman of White, Weld & Co.

73. Stewart Myers, a cross-town rival of Richard Meyer, is a Professor of Finance at the Sloan School of Management, Massachusetts Institute of Technology. Like Meyer, he has written extensively in this field.

74. The theory behind AWCC is the same as that behind the segmented earnings approach to valuation. See Gardner, The SEC and Valuation Under Chapter X, 91 U. Pa. L. Rev. 440, 460-64 (1943).

75. Even if we accepted Stewart Myers' approach in theory, we would have no reliable way of implementing it. Because railroad bonds, as opposed to stocks, are not frequently traded, Myers had to estimate their market values. He did this in two different ways and derived upper and lower bound estimates of their true values. See Myers (S) (Dec. 1, 1978) App. C. the GPs showed, however, that Myers' upper and lower bound estimates were too high and that, since he relied on this range of figures, his estimated debt ratio was also too high. See 8 GP at App. R 231-32.

76. Roll also argued that an acquirer would have used a 30 percent debt ratio. He contended that an acquirer of the IFLs would have used less debt than that used by the average railroad because it would not have been able to take full advantage of the tax benefits resulting from the IFLs' rehabilitation. Roll (S) (Jan. 30, 1980) at 113-17. Whatever the merits of this proposition, see Myers (S) (Oct. 15, 1980) at 41, the GPs have presented no evidence showing that acquirers of EL's LV's, AA's, or L&NE's lines would have been in a similar position.

77. Stocks, Bonds, Bills and Inflation: The Past (1926-76) and the Future (1977-2000) (1977).

78. Smith initially derived this rate for the IFLs. See Smith (S) (Jan. 30, 1980) at 65, 133-35. Based on his judgment, he assumed that the level of risk associated with the proffers of the individual Ts would be the same as for the IFLs. *Id.* at 252-53 (EL), 285-87 (LV), 292-94 (AA), 308-10 (L&NE).

79. The importance of the disposition date is essentially limited to the inflation factor since the real rate of return is derived from long-range historical data. To factor in inflation, one multiples the appropriate inflation factor by one plus the interest rate and then subtracts one.

The nominal rate of return for an average risk investment as of April 1, 1976 would therefore be 15.69 percent—1.092 x 1.0594 (the inflation factor) minus one.

80. For example, the fact that an industry is regulated does not necessarily imply that it is risky—utilities, among the most heavily regulated industries, historically have been regarded as being among the least risky.

81. EL makes much of its claim that it was different from the other bankrupts. In support of this, it points to the fact that its entry into bankruptcy was precipitated by a natural disaster and that "as late as 1974, EL was thought to be independently reorganizable". 2 ELF at 425. Yet the fact of the matter is that EL, like the other Ts, was ultimately found not to be independently reorganizable.

82. The GPs also presented testimony from five witnesses—Evan Allen, Senior Financial Analyst for Southern; Paul Zeis, Director of Research for Norfolk & Western; Frank Barnett, former Chairman of Union Pacific; Thomas Lamphier, current President of Burlington Northern; and Alan Boyd, former President of Illinois Central Gulf and current President of Amtrak—all of whom stated that an investment in the Ts' lines would have been viewed as riskier than investment in their own operations.

83. We conclude, *infra*, see p. 187, that the parties would have reached an agreement on the prices for the Ts' properties ten to twelve months after negotiations began in February 1973. For purposes of valuation, we will assume that potential acquirers would have valued the Ts' properties on January 1, 1974.

84. The GPs' witness, Roll, developed formulas which allow one to estimate the yield on railroad debt by factoring in its rating and the yield on U.S. Government bonds of comparable maturity. See Roll (S) (January 30, 1980) at 84-101. Assuming a 20 year term, the yield on A-rated senior mortgage debt as of January 1, 1974 would have been 9.155 percent and the yield on Aa-rated equipment trust certificates would have been 9.03 percent. Leaving aside the overall reliability of Roll's equations, we think that they yield unreliable results in this case. First, they fail to predict the actual yields which we have noted. Furthermore, the differential between the A and Aa-rated bonds is implausibly small.

85. In S&P's two reports, the proposed acquisitions are referred to at times by numbers known as proffer codes and at other times by Roman numerals. The table below identifies the proffer codes of the Ts whose RC and MOWE are discussed in this opinion:

Proffer Code	Proposed Acquisition
33	AA (Toledo-Ann Arbor segment)
35	R
82	EL I (Western Acquisition)
83	EL II (Chessie Acquisition)
86	EL III (Western Acquisition)
87	EL IV (Chessie Acquisition)
88	LV
89	LV III, IV (Historical)
42	LV III, IV (Projected)

1980 Study at VIII 5. The EL III and EL IV proffer codes cover the EL lines in the joint EL-LV acquisitions. The LV III and LV IV proffer codes cover the LV lines in the joint systems. The estimates designated by proffer code 89 are based on actual 1973 traffic on those LV lines, while those under proffer code 42 are based on the projected higher traffic after a combination with EL.

86. For example, EL estimated RC on its lines in the proposed Chessie acquisition to be about $27.76 million in 1973 dollars; S&P's figure was $148.299 million. See Statement of the EL Trustees in Response to the Court's May 21, 1981, Memorandum (June 1, 1981) at 11, Sp. Ct. Rep. at N 35810.

87. The 1979 Study developed RC including overhead for all lines of each T, expressed in 1974 dollars and premised on an assumed 1974 disposition date. It did not, however, cover either the scheduling of rehabilitation work or the development of annual MOWE. The 1980 Study developed RC and normalized MOWE without overhead for each of the Ts' proposed acquisitions, set out a schedule for the rehabilitation program, and expressed costs in 1973 dollars. In June 1980, Morgan made changes to portions of the 1980 Study's RC and MOWE estimates to account for newly discovered data and errors pointed out by the Ts during Morgan's deposition. See H. Morgan Corrections (S) (June 6, 1980).

88. Before his retirement in 1974, Morgan spent 38 years in various managerial and maintenance positions with the Penn Central Transportation Company, the Pennsylvania Railroad, and the United States Army. H. Morgan (S) (Jan. 31, 1979) at 1-3.

Gunderson, a licensed professional engineer, spent 26 years of his career directly and solely involved with bridges. He spent the remainder of his 43-year career supervising others who were directly involved in maintaining the facilities of the Western Maryland Railroad. Upon his retirement as Assistant Vice-President of Engineering in 1972, he served as a railroad consultant. Gunderson (S) (Jan. 31, 1979) at 1-3.

89. A work function is a quantification of the labor, equipment, and materials needed to perform a particular rehabilitation task. For example, one of the work functions defined the amount of labor, equipment, and materials needed to replace one mile of track with new 119-pound rail in one eight-hour work day. Most of the work functions developed by S&P are independent of one another and describe all the elements necessary to complete a particular rehabilitation task. Some work functions cannot be performed alone, however, and are combined with others to form a series of continuous operations. These groupings of work functions are called "work items". The methods used to derive the various work functions and work items are described in detail in the 1979 Study at V. For a listing of all the work functions and work items, see 1 1980 Study App. IV.

90. See 14 GP Supp. App. at 701-28. Because the figures on the pages cited do not reflect credits for the salvage value of replaced rails, the sum of all rail, turnout, and crossings rehabilitation for any particular proffer code will be higher than the figure for total track rehabilitation listed for that proffer in H. Morgan Corrections (S) (June 6, 1980) at Table VIII-2aA. Even if all the salvage credit were applicable to rail replacement, rail replacement would still be the dominant item of track rehabilitation.

91. In most instances, sound business practice dictates removal and relaying before safety considerations require removal, for if the rail is left in its first position too long, its life for some second-position uses will be too short to merit the cost of installation. As a result, the decision to remove and replace rail generally depends on a railroad's need for used rail. If mainline rail were destined for use in branch lines, it would be removed earlier than if destined for yard use, where even excessively worn rail has an extended useful life. 1 ELF at 160 n.118; H. Morgan (D) (Aug. 11, 1980) Ex. 134, EL App. E at 212.

In basing his rail replacement decision on the American Railway Engineering Association headwear standards, Morgan did not consider the needs of the Ts or their potential acquirers for used rail.

92. The AREA table is reproduced in the 1979 Study at III 30.

Appendix H

93. Rail is manufactured in a number of different weights, expressed in pounds per yard of rail; the heavier the rail, the greater the allowable headwear.

94. See H. Morgan (D) (May 7, 1980) at 3036-41, EL App. D at 317-22. The S&P Study itself states, "Since the most economical rail use is to relay it in the next lower class, rail should be removed when the headwear approaches the value indicated in Table III-14". 1979 Study at III 31.

95. The S&P Study states, "The Table, of course, does not represent the actual minimum limits which indicate when rail must be removed from a track. It is, instead, a guide for indicating the class of track in which a given rail may be relaid." 1979 Study at III 27 to 28; see also 3 GPRB at App. A 42.

96. At Morgan's deposition, D. A. Diestelkamp, one of two assistants assigned to making rail replacement decisions, testified as follows:

> Q. Mr. Diestelkamp, when you had a piece of 140-pound rail in Class 1 which had a quarter-inch wear, would that be a strong indicator for you of removal? A. That would be one of the factors, yes.
>
> Q. Would that be a strong indicator, a major factor? A. It would depend on the other criteria that is [sic] listed in the Bechtel date.
>
> Q. I understand that. I think Mr. Morgan had said that wear is one of the important factors. A. That is correct.
>
> Q. In your work didn't you regard this quantitative measurement as a major indicator of a need to replace? A. That is correct.
>
> Q. And when you found out the wear reached a quarter of an inch in Class 1, in most cases you replaced that rail, did you not? A. That's true.
>
> Q. If we were to go through all of these forms, we would find out that you replaced virtually all of the rail that exceeded that limit; isn't that correct? A. Within the confines of what you just stated, yes.

H. Morgan (D) (Apr. 14, 1980) at 202, El App. C at 24-25.

97. Class IV lines, which are yard lines, were considered separately.

98. Morgan did not have Bechtel Study data for all the lines in the EL Western acquisition. See 1979 Study at IV 10-11.

99. Tables showing the FRA track classifications and limits on allowable end batter and mismatch can be found in the 1979 Study at III 5, III 26. The standards used by Morgan, extrapolated from the FRA figures, are shown *id.* at III 41.

100. To the extent that Morgan overstated rail replacement, he also substantially overstated total track RC. It is possible, of course, that, even if he had chosen not to replace particular stretches of rail, those stretches would have required some other forms of rehabilitation. The GPs make essentially this sort of argument, although in a different context, with respect to AA. See 3 GPRB at App. A 83. Nonetheless, the unit costs for the various work functions and work items related to rail replacement are so much larger than those for other forms of tracks rehabilitation that the choice of one of the latter instead of one of the former would have reduced track rehabilitation costs considerable. *Compare* 2 1980 Study App. at IV-1-1 to IV-1-10, IV-2-1 to IV-2-2 *with id.* at IV-1-11 to IV-1-17, IV-2-2 to IV-2-3.

101. The GPs attack EL's attempt to rely on the Bechtel Study rail replacement estimates as proof of the excessiveness of Morgan's rail replacement estimates. The Bechtel Study estimates were prepared by the engineering firm of Deleuw, Cather & Co. under the technical direction of Bechtel, Inc. The GPs argue that the DeLeuw team incorrectly used the sample data they had obtained from visual inspections of EL's lines. See 1 GPRB at E 35-40. As the GPs acknowledge, their argument is based on a statement by EL's counsel about how DeLeuw used the sample data. As far as we can tell, neither party introduced evidence concerning the complete methodology DeLeuw used in making rail replacement decisions.

Nevertheless, at least one piece of information about DeLeuw's methods is known. It is generally agreed that DeLeuw inspected samples of track at two-mile intervals. EL counsel asserted that, unlike Morgan (who used the DeLeuw data in his study), DeLeuw did not treat the sampled portion as necessarily representative of conditions throughout the two-mile interval. Instead, they looked at other track records to determine whether conditions on the unsampled portion (*e.g.*, the rail's installation date, the curvature of the track if any, etc.) were similar to conditions on the sampled portion. The GPs argue that this method understated rail replacement because if the sampled portion showed deterioration, DeLeuw replaced only that part of the unsampled portion where conditions were similar to conditions on the sampled portion; on the other hand, where the sampled portion was good, DeLeuw did not replace any rail even though it is possible that only a short distance beyond the sampled portion deterioration was such that replacement was needed.

We see no basis for that assumption about DeLeuw's rail replacement methodology. If DeLeuw supplemented its visual inspections with additional track records, it is just as likely that they could have determined that, because conditions on the sampled and unsampled portions were dissimilar, rail replacement was needed in the unsampled portion even though it was not needed in the sampled portion. Although we cannot know for sure how DeLeuw made its rail replacement decisions, if their method did take into account additional data besides that obtained from visual inspections, then it is likely to be more reliable than Morgan's method of treating each sample as representative of an entire two-mile stretch of rail.

The GPs also point out that, even if DeLeuw's rail replacement percentages are significantly lower than Morgan's, DeLeuw's total rehabilitation estimate for all non-bridge items is significantly closer to Morgan's figures for those items than it is to EL's figures. As the Chessie Study points out, however, see Chessie Study at 14-22, EL App. B at 217-18, DeLeuw probably overstated rehabilitation in a number of ways. Indeed, Chessie felt that DeLeuw's estimate should be discounted by at least 40 percent. Chessie Study at 26, EL App. B at 220. As a result, we do not find the similarity between DeLeuw's and Morgan's rehabilitation figures for non-bridge items very probative.

102. Total costs for turnout and highway crossings replacement (before salvage credit) for each T are as follows:

AA	$ 287,015
R	$ 1,517,512
EL I	$10,658,020
EL II	$ 8,994,707
EL III	$ 9,607,427
EL IV	$ 7,771,870
LV	$ 4,147,221
LV, III, IV	$ 3,167,955

See H. Morgan (D) (Aug. 22, 1980) Ex. 280, EL App. E at 278-81. The Roman numerals for EL and LV signify the various alternative configurations they proposed depending on which railroad or public entity acquired their lines. See note 85, *supra.*

103. The Bechtel Manual, a guidebook provided to the six subcontractors who did the field work for the Bechtel Study, originally specified sampling rates as high as 50 percent for some types of bridges; sampling rates for other types of bridges ranged below that figure to as low as 5 percent. See Gunderson (D) (May 15, 1980) Ex. 10 at 6-5, EL App. G

at 185. Apparently, these rates were later cut in half. *Compare id. with* 1 1979 Study App. at III-2-1.

104. The Bechtel field forms for bridges contained three possible designations for the condition of each item specified on the form: A (good), B (fair), R (repair). The Bechtel Manual defined the B category as follows: "The second answer [fair] should be used when the inspector believes that the item could develop a problem in the future and should be watched, but no repairs are merited at the present time." Gunderson (D) (May 15, 1980) Ex. 10 at 6-7, EL App. G at 187. Gunderson's interpretation of the B rating appears to have been at odds with this definition. Under his interpretation, even bridges with some B ratings and no R ratings were scheduled for repairs. See 1980 Study at IV 28; Gunderson (D) (May 16, 1980) at 458-60 (by R.A. Wokurka), EL App. F at 56-58.

105. Although there was enough data on PC yards to allow Morgan to use a separate sample to determine PC's yard rehabilitation estimate, Morgan did not have enough data to use separate samples for the other Ts. See 3 GPRB at App. A 27-29.

106. The number of miles in mainline track determined S&P's figures for each T's yard track mileage and yard turnouts. To obtain figures for each T's yard track mileage and yard turnouts, S&P used Conrail's systemwide ratios for the number of yard track miles to mainline miles and for the number of yard turnouts to yard track miles. H. Morgan (D) (Apr. 23, 1980) at 1611-13, EL App. C at 240-42. Some modifications to this approach were made in the 1980 Study; they did not affect EL, LV, and AA. H. Morgan (D) (Apr. 23, 1980) at 1614-16, EL App. C at 245.

107. For EL, replacement costs (before salvage credit) for small yard turnouts on each of its four proffers ranged from $4,061,333 to $6,371,844. For LV, the figure was $3,745,611. See 1 ELF at 212.

108. Section 215 of the Rail Act, 45 U.S.C. § 725, provided funds for interim maintenance and improvements pending conveyance of the Ts' properties to Conrail.

109. See note 25, *supra*.

110. Shannon (S) (EL) (Dec. 31, 1978) at 52-54. Shannon defined his standard as follows:

> Generally, one can consider that a railroad in "50%" condition is in good operating condition. For example, if the anticipated tie life is 35 years, at the end of 17½ years the ties are in 50%

condition but can still adequately perform the function for which they were installed.

Id. at 52. This standard appears to be the generally accepted interpretation of normal condition. See 3 GP at K 39 n.17.

111. Shannon (D) (July 9, 1979) at 1004-06, EL App. B at 1-3. In its brief EL incorrectly states that Chessie's figure was stated in 1975 dollars. 1 ELF at 135. Shannon testified however that, although the Chessie Study used 1975 freight rates, it used projected 1976 cost levels. Shannon (S) (EL) (Dec. 31, 1978) at 82. EL quotes Shannon on this point earlier in its brief. See 1 ELF at 46. The evidence cited *id.* at 46 n.37 is sufficient to prove that Shannon was correct.

112. The pro forma statements prepared by Shannon for each acquisition contained two maintenance accounts, — catch-up maintenance, and "normalized maintenance". There was no separate account for routine yearly maintenance. That cost was reflected in the figure for net operating income and was based on actual 1973 expenditures. "Normalized maintenance" represented the amount of additional maintenance expenditures that should have been incurred in 1973 to avoid deterioration. Put another way, "normalized maintenance" plus the sum actually expended for maintenance in 1973 would, in Shannon's opinion, keep EL in optimum operating condition once catch-up maintenance had been performed. Catch-up maintenance was merely the cost to rehabilitate the lines to optimum operating condition.

113. To use an example employed in LV's examination of Murphy, if a railroad decides to lay 119-pound rail instead of 136-pound rail in its rehabilitation program, its annual MOWE budget should be adjusted to account for the fact that the lighter rail wears faster and will have to be replaced sooner than the heavier rail. B. Murphy (D) (June 20, 1980) at 138-39, 2 LV App. at 262-63.

114. In the Statement of the Erie Lackawanna Trustees in Response to the Court's May 21, 1981, Memorandum (June 1, 1981) at 9-12, Sp. Ct. Rep. at N 35808-11, EL points out three errors in the GPs' calculations: (1) the Chessie figures used by the GPs covered a package of lines that is 5.8 percent larger than the package EL's estimate covered; (2) Chessie's rehabilitation figure did not contain an adjustment for shortfall that EL's estimate contained; and (3) Chessie's figures were not accurately restated in 1973 dollars because the GPs incorrectly assumed that Chessie's figures were stated in 1975 rather than 1976 dollars. This error by the GPs was perhaps induced by EL's opening brief which incorrectly stated that the Chessie study expressed rehabilitation in 1975 dollars. See note 111, *supra.*

EL also takes issue with the figure the GPs assigned as EL's estimate of annual MOWE. Annual MOWE is not stated separately in Shannon's study and cannot be computed without complicated calculations. The GPs therefore used a rough approximation. 1 GPRB at E 26 n.80. EL's own rough approximation is about $1.6 million higher. Multiplied by ten, the difference in the two estimates is substantial. Nevertheless, even accepting the GPs' figure for the EL estimate, but correcting for the three other errors discussed above, the combined rehabilitation and ten-year MOWE figure using EL's estimate of the combined total is 79 percent of Chessie's estimate, while the GP's estimate is 160 percent of Chessie's estimate.

115. The GPs came up with the following figures for the total costs of rehabilitation plus ten years of routine annual MOWE: $431,300,000 using S&P's estimates, $318,643,000 using Chessie's estimates, $203,878,000 using Shannon's estimates. As modified to correct the errors EL found in the GPs' calculations, the figures look like this: $431,300,000 using S&P's figures, $269,118,000 using Chessie's figures, and $229,080,000 using EL's figures.

116. For example, if most wage increases occur around March, Shannon's January 1, 1975, cost levels would reflect the March 1974 increase. The AAR 1974 indices would therefore be an accurate indicator of the actual cost levels Shannon used since those indices provide year-end 1974 figures and Shannon's January 1, 1974, figures would contain no wage increases not contained in the AAR index. the 1973 AAR indices would reflect the 1973 post-March labor costs and thus would accurately reflect the costs obtaining during the maintenance season (March through October). The proper comparison would therefore be between the 1974 and 1973 AAR indices, a one-year adjustment rather than the two-year adjustment Shannon made.

117. See note 108, *supra*.

118. The Adik study that valued all LV lines conveyed to Conrail use a computerized costing model to determine revenues, expenses, and capitalized earnings value. The study does not provide discrete figures for RC and MOWE: rather, those costs are buried in a number of different accounts. The parties have not attempted to extract from the study the pertinent figures for RC and MOWE for the LV lines in the combined systems. We have not been able to determine how to extract them ourselves. See generally Adik (S) (December 31, 1978) Ex. 1.

119. LV's traditional procedures and equipment were older and less efficient than the procedures and equipment employed by the USRA in the § 215 program undertaken in 1975 and Adik believed that similar work techniques and machinery would also have been used by a solvent acquirer.

120. Murphy also testified that the figures presented by the S&P Study were a more reliable indicator of LV's needs. B. Murphy (S) (Jan. 30, 1980) at 14. We hesitate to rely on this statement, however. Murphy endorsed S&P's original estimate of $62.35 million for the RC of the LV lines in the EL-LV proffers. When Morgan and Gunderson subsequently revised their estimate of RC for LV to $52.99 million Murphy endorsed the reasonablness of that figure without even examining the errors that they corrected. B. Murphy (D) (Aug. 29, 1980) at 193-207, 2 LV App. at 280-86. Murphy explained at his deposition that the two S&P figures represented a reasonable range of estimates. But his written testimony made no such qualification. And his deposition also revealed that he was generally unfamiliar with the way in which Morgan and Gunderson conducted their studies. B. Murphy (D) (Aug. 29, 1980) at 216-18, 222-31, 2 LV Supp. App. 295-97, 301-09. In light of all this, we do not find Murphy's endorsement of the S&P Study to be especially probative.

121. S&P placed rehabilitation on LV's lines in the combined EL-LV systems at $44.65 million and annual MOWE at $6.871 million. H. Morgan Corrections (S) (June 6, 1980) at Tables VIII-2aA, VIII-2bA. Adik placed rehabilitation at $7.775 million and annual MOWE at $9.766 million. Adik (S) (EL) (Dec. 31, 1978) Schedules 11 and 14.

122. The following figures are approximations of the cost per main-line track mile for EL and LV: EL—$11,000; LV—$14,204. The EL figure was developed by taking the figure for total rehabilitation (with § 215 adjustment) on EL's lines in the EL-LV Western acquisition as presented in Memorandum of the EL Trustees in Response to the Court's Letter of June 19, 1981 (July 10, 1981) at Table A (following p. 11), Sp. Ct. Rep. at N 36164, determining the proportionate share (with § 215 adjustment) attributable to the cost of rehabilitating JT lines, and dividing by the total mileage figure for Proffer Code 86 in the 1980 Study at VIII 5. LV's figure is the $7.775 million estimate from Adik (S) (EL) (Dec. 31, 1978) Schedule 14, divided by LV's mileage figure in the 1980 Study at VIII 5.

123. Hale did not analyze how a reduction in speed would affect any track rehabilitation estimates other than rail replacement.

124. The entire exchange on this point was as follows:

Q. If you look at the computer printout for line 6903, you are showing a net total rehabilitation figure of $487,000, and this represents rehabilitation to a maximum speed of 40 miles per hour; correct? A. Correct.

Q. Based upon the fact that, under the assumptions made by the Ann Arbor in the rail use case, this line would only be operated at 25 miles an hour, could you tell me—could you tell the difference in rehabilitation costs that would be provided solely for an FRA Class II railroad? A. Not offhand.

Q. Would it be more than 50 percent? A. You mean 50 percent less?

Q. 50 percent less. A. No.

H. Morgan (D) (Aug. 19, 1980) at 4574, 28 GP Supp. App. at 346.

125. Indeed, given Morgan's tendency to overstate RC, it is likely that Hale's use of stricter standards overcompensated for his short-term perspective.

126. The figures for mainline ties and turnouts were calculated from Hale's estimates for the segments of AA from Toledo to Diann and from Diann to Whitmore Lake, making an adjustment because the Diann-Whitmore Lake segment extends 9.5 miles beyond the Ann Arbor city limits, Hale (S) (Dec. 31, 1978) at 3.

Mainline Ties

Toledo-Diann:

Units	*Unit Cost*	
400	$25	$10,000

Diann-Whitmore:

Units	*Unit Cost*	
8500 / 36.5 miles = 6288 x (36.5 - 9.5) miles	$20	$125,760
Total		$135,760

Appendix H

Turnouts

Toledo-Diann:		
Units		
0	$0	
Diann-Whitmore:		
Units		
10 x (36.5 - 9.5) miles		
36.5 miles = 8		
	$7,500	$60,000
Total		$60,000

See Laughlin (S) (Dec. 31, 1978) Ex. AA-MOL-1 at B 2-3.

127. See p. 86, *supra*.

128. The EL ratio, as calculated by EL from its Schedule 411 data, is 46 percent, while Conrail's systemwide ratio is 53.4 percent. 1 ELF at 284, 219. EL's ratio is about 14 percent lower than Conrail's. EL incorrectly quantified the difference as 15 percent. See 1 ELF at 284. A 14 percent reduction in yard maintenance on EL's Western acquisition amounts to $1.25 million. See H. Morgan Corrections (S) (June 6, 1980) at Table VIII-2bA. EL also contends that Morgan overstated mileage by treating some lines as double track lines instead of single track lines. 1 ELF at 284. EL did not quantity the amount of overstatement, however, so we presume that this error, like the 43-mile error relating to a line maintained by B&O, *id.*, was not significant.

129. EL had no lines with densities above 20 MGT, see 3 GPRB at App. A 46-47, so according to the 1980 Study, none of its rail had an annual replacement rate over 2.5%, and some had an even lower rate. The 2.5 percent figure contemplates a 40-year rail life because at that rate all the rail in a given line will have been replaced at an average of once every forty years.

130. *E.g., Susquehanna & N.Y.R.R.—Abandonment*, 252 I.C.C. 81 (1942); *Cisco & N.E. Ry.—Abandonment*, 267 I.C.C. 139 (1947); *Black Mountain Ry.—Abandonment*, 290 I.C.C. 238 (1954); *Manistee & Repton R.R.— Abandonment*, 324 I.C.C. 489 (1964); *Okmulgee Northern Ry.—Abandonment*, 320 I.C.C. 637 (1964); *Tennessee Central Ry.—Abandonment of Operations*, 333 I.C.C. 443 (1968), *modified*, 334 I.C.C. 235 (1969); *Bush Terminal R.R.—Entire Line Abandonment*, 342 I.C.C. 34 (1971); *Northampton & Bath R.R.—Abandonment*, 354 I.C.C. 784 (1978). The ICC, in situations

similar to those in the foregoing cases, has imposed labor protection conditions, *e.g., Seaboard Air Line R.R. Trackage Rights*, 312 I.C.C. 797 (1962); *Washington & Old Dominion R.R. Abandonment—Virginia*, 331 I.C.C. 587, *complaint dismissed sub nom. Washington & Old Dominion Users Ass'n v. United States*, 287 F.Supp. 528 (E.D. Va. 1968). Although the distinctions drawn by the Commission are not altogether clear, it appears that protective conditions have been imposed only in situations where a parent corporation derives substantial benefits from the abandonment of its subsidiary's lines. We think the ICC would have found this exception inapplicable if, in the alternative scenario, a T abandoned its entire system for scrap value.

131. See, *e.g., In re Chicago, Rock Island & Pacific R.R.*, No. 75 B 2697 (N.D. Ill. June 5, 1980) Partial Transcript of Proceedings at 4 ("that Congress believes that it can legislate a $75 million labor protection burden on the assets of the Rock Island comes to me as a startling concept") (McGarr, J.), *application for stay denied sub nom. Railway Labor Executives' Ass'n, v. Gibbons*, 448 U.S. 1301 (1980) (Stevens, J.) and 448 U.S. 909 (1980) *decision on probable jurisdiction postponed and case consolidated with No. 80-1239*, 49 U.S.L.W. 3806 (U.S. April 27, 1981) (No. 80-415); and *In re Chicago, Rock Island, & Pacific R.R.*, No. 75 B 2697 (N.D. Ill. Oct. 15 & 16, 1980), *aff'd sub nom. Railway Labor Executives' Ass'n v. Gibbons*, Nos. 80-2487 & 80-2536 (7 Cir. Dec. 16, 1980) (by an equally divided *en banc* court), *probable jurisdiction noted and case consolidated with No. 80-415*, 49 U.S.L.W. 3806 (U.S. April 27, 1981).

132. The GPs argue briefly that the Penn Central Merger Protection Agreement (PCMPA) would have been applicable to LV and AA as direct or indirect subsidiaries of PC, although they do not attempt to calculate the costs of the benefits of the agreement. 5 GP at S 46. LV rightly points out that the PCMPA required PC, and not LV, to bear responsibility for labor protection payments. See *Pennsylvania R.R.—Merger—New York Central R.R.*, 347 I.C.C. 536, 551 (1974). Moreover, our conclusions as to the uncertainty that would have surrounded the applicability of the Erie Lackawanna Merger Protection Agreement, see pp. 106-09, *infra*, also apply to the PCMPA. Accordingly, we accept LV's argument that the PCMPA would have had no effect on its labor protection costs. The same considerations apply to AA.

The GPs apparently also contend, 5 GP at S 47, that the February 7, 1965 Job Stabilization Agreement would have applied to EL and LV in

the circumstances of the proffered transactions, although the GPs again do not consider this agreement in their calculation of the Ts' labor protection costs. The agreement applied only to nonoperating employees employed by a T on October 1, 1962. Because employees generally would have been terminated in reverse order of seniority and most 1962 employees would have achieved relatively high seniority by 1973-74, the agreement would have had little practical effect on the Ts' labor protection costs. In any event, our conclusions regarding the uncertainty that would have surrounded the question whether the Erie Lackawanna Merger Protection Agreement was applicable to the proffered transactions, see pp. 106-09, *infra*, are equally applicable to the February 7, 1965 Job Stabilization Agreement.

The GPs also argue briefly, 5 GP S at 253-56, that other agreements with third parties—such as equipment financing obligations, fuel contracts, and the like—would have reduced the price of the Ts' properties. As regards the Ts remaining in the case, virtually no evidence has been presented in support of this theory. Moreover, the GPs cite us to no transaction comparable to those proffered in which such agreements have affected the purchase price. Accordingly we reject the GPs' argument.

133. The GP's argument, 2 GPRB S at 112 n.277, citing Minutes of May 13, 1936 at 5; 22 GP Supp. App. at 289 (statement of Mr. Harrison), that the WJPA negotiation minutes "reveal an intent to cover all attempts to unify 'by a device'" is unpersuasive. The portions of the negotiations cited by the GPs reveal only an attempt to prevent circumventions of the WJPA, and not an explication of the scope of that agreement.

134. We are unpersuaded by the conclusory statements of the GP's witness, Dr. Jacob Seidenberg, that a neutral arbitrator would have found the WJPA applicable in the circumstances of the alternative scenario. Seidenberg (S) (Jan. 31, 1979) at 36-37. As the GPs concede, Seidenberg did not consider the particular circumstances of the Ts' cases nor the arguments that the Ts might have advanced in arbitration. 5 GP at S 81; Seidenberg (D) (Apr. 10, 1980) at 122, EL App. M at 203.

135. EL's inclusion in the Norfolk & Western system was accomplished by Norfolk & Western's purchase of EL's stock, which Norfolk

& Western regarded as a complete loss following EL's entering reorganization. See also *Matter of Erie Lackawanna Ry.*, 404 F.Supp. 954 (1975).

136. The most generous type of labor protection is "attrition protection", which guarantees employment or its equivalent in wages and fringe benefits until an employee dies, retires, resigns, becomes disabled, or refuses to accept a bona fide job opening. The ELMPA, the PCMPA, and other agreements provided attrition protection for covered employees.

137. See cases cited in note 130, *supra*.

138. We do not think that the refusal of labor unions to reach agreements with Chessie and Southern regarding acquisition of the EL system and PC's Delmarva lines indicates that labor would have blocked the proffered transactions. In the event that the Chessie and Southern acquisitions failed, the EL and PC lines were to be acquired by Conrail, and the employees on these lines would receive the extremely favorable labor protection benefits provided by the Rail Act. In the alternative scenario, labor would have had no such protection and would have faced the possibility of widespread shutdowns in the Northeast.

139. Amtrak C-1 benefits, negotiated pursuant to the Rail Service Passenger Act, 45 U.S.C. § 565, and incorporated in the 1971 Passenger Service Agreement between Amtrak and Penn Central, provide dismissed employees with a choice of a lump sum separation payment or a monthly dismissal allowance equal to 100 percent of their base period salary for up to six years following termination. Ex. GPS—Labor 27. We do not think this agreement is particularly instructive in our case. The Rail Service Passenger Act provided labor with a guaranteed level of benefits, 45 U.S.C. § 565(b), and the availability of federal intervention made it highly unlikely that the Ts would actually cease operations.

140. LV contended that it would have avoided any labor protection obligations, as did AA. Shannon took the view that labor would have "panicked". Shannon (D) (Jan. 15, 1981) at 652, 30 GP Supp. App. at 179.

141. The Rock Island and Milwaukee liquidations gave rise to agreements between labor and the potential purchasers of the lines involved regarding labor protection. These agreements — the "Miami accords" — provided 80 percent of base period compensation for up to three years for employees hired on the Rock Island and Milwaukee

systems. As the GPs recognize, 2 GPRB at S 85 n.216, these terms were less than those labor historically had obtained. The GPs point out, however, that workers who failed to find employment on the Rock Island and Milwaukee lines were protected by special federal legislation. 2 GPRB at S 80 & n.201. The restructuring of the Rock Island and Milwaukee nonetheless involved labor "concessions . . . in the amount and duration of salary guarantees", 2 GPRB at S 85 n.216, and, although coming several years after the transactions hypothesized in this case, belies the GPs' claims of an uninterrupted trend towards increased labor protection. See also *R.D. Timpany, Trustee of the Central R.R. Co. of New Jersey—Abandonment of Operations between Phillipsburg, N.J. and Hudson, Pa.*, 342 I.C.C. 227, 301 (1972) (minimal labor protection benefits imposed in partial line abandonment).

142. If labor protection costs exceeded the excess value of rail use sales over scrap values, then it would be more profitable for a T to choose to scrap, thus avoiding labor protection costs. See pp. 103-04, *supra*.

143. Considerations that would have influenced the outcome of negotiations between the Ts and labor would have included the bargaining skill of the various parties, the parties' perceptions of the willingness of other parties to risk blocking rail use sales, and the parties' perceptions of the value of rail use sales. We do not attempt to quantify such intangibles.

144. The ICC devised the *New Orleans* conditions in response to the Supreme Court's direction in *Railway Labor Executives' Ass'n* v. *United States*, 339 U.S. 142 (1950), that it provide a "fair and equitable arrangement" pursuant to § 5(2)(f). See *New Orleans Union Passenger Terminal Case*, 282 I.C.C. 271, 281-82 (1952).

145. See examples cited in Ables, *supra*, at 136-37.

146. Kasher, a lawyer specializing in labor law, has held numerous positions in the railway labor field. He served as General Counsel on the National Mediation Board, as director of Conrail's Title V Administration, and has been employed as a consultant and labor arbitrator. Kasher (S) (Nov. 1, 1979) at 1-3. He had not, however, had any real experience in the computation of labor protection costs prior to this case. Kasher (D) (May 5, 1980) at 42, I LV App. I at 60.

147. A "nonagreement employee" is an employee unprotected by existing agreements.

148. Kasher estimated that 3,575 PC, 348 EL, and 139 LV nonagreement employees would have been terminated as a result of the proffered transactions.

149. If we were to conclude that more positions would have been lost following acquisition than the T's Pro Formas reflect, we would then be required to reduce the T's projected labor expenses. Because LPCs for an employee are less than the cost of retaining the employee in employment this would only benefit the Ts.

150. The PC "refined case" was devised by PC witness Edward Jennison, Jennison (S) (PC) (Dec. 1, 1979) at 29-31, simply to test the profitability of PC's IFLs assuming relatively extensive abandonments by the other Ts. No evidence was submitted that the "refined case" would have been the likely disposition of the Ts' lines in the absence of the Rail Act.

151. This result follows from our conclusion, p. 259, *infra*, that there would have been several Western lines bidding for the EL-LV Western package and Chessie bidding for the EL-LV Chessie package. If a Western line bid would have been higher than the Chessie's bid then we obviously do not have to estimate LPCs for the Chessie. On the other hand, if the Chessie, taking into account the X of the Chicago-Sterling line, would have been willing to pay more than any Western acquirer we again need only consider the LPCs to a Western acquirer because Chessie would have only have had to pay a nominal amount more than that the Western acquirer would have bid.

152. See, *e.g.*, Kasher (D) (Aug. 13, 1980) at 1884 (by Rybicki), EL App. M at 13; Kasher (D) (Aug. 13, 1980) at 1837 (by Willey), EL App. L at 304; Kasher (D) (May 6, 1980) at 262 (by Willey), EL App. L at 38; Kasher (D) (May 6, 1980) at 266 (by Willey), EL App. L at 39; Kasher (D) (Aug. 13, 1980) at 1860-63 (by Willey), EL App. L at 322-25; Kasher (D) (Aug. 13, 1980) at 1868-74 (by Willey), EL App. M at 1-7; Kasher (D) (Aug. 13, 1980) at 1892-98 (by Rybicki), EL App. M at 17-22; Kasher (D) (May 6, 1980) at 83 (by McDonough), EL App. L at 3.

153. See, *e.g.*, Kasher (D) (Aug. 13, 1980) at 1876-78 (by Willey), EL App. M at 9-11; Kasher (D) (Aug. 13, 1980) at 1839-49, 1860-63 (by Willey), EL App. L at 306-16, 322-25.

154. See Kasher (D) (Aug. 13, 1980) at 1850 (by Willey), EL App. L at 317; Kasher (D) (Aug. 13, 1980) at 1889 (by Rybicki), EL

App. M at 16; Kasher (D) (May 6, 1980) at 266 (by Willey & Rybicki), EL App. L at 39. See also Kasher (D) (May 6, 1980) at 256-58 (by Willey), EL App. L at 35-39; Kasher (D) (Aug. 13, 1980) at 1853-54, EL App. L at 318-19; Kasher (D) (May 6, 1980) at 226, EL App. L at 31.

155. A number of Shannon's assignments with Wyer, Dick & Co. involved labor and labor protection matters. Shannon (D) (June 21, 1979) Ex. 2, EL App. A at 1-6. See also note 25, *supra*.

156. The 1,819 figure was derived from Exhibit 16 based on the following methodology: addition of sheet 1, column 1, line 7 (14 positions); sheet 2, column 1, line 8 (166 positions); sheet 3, column 1, line 11 (39 positions); sheet 4, column 1, lines 7 & 28 (0 positions); sheet 5, column 1, line 6 (2 positions); and sheet 6, column 1, line 11 (97 positions), gives a total of 318 positions. Application of this method to the remaining years yields a total of 1,819. This figure includes the positions that Shannon concluded would have been eliminated from EL's rehabilitation and capital improvement programs. Although Shannon's workpapers net jobs abolished against those created, we have not done so, to reflect difficulties in relocating surplussed employees. For example, for year 2, addition of sheet 1, column 2, line 7 (41 positions); sheet 2, column 2, lines 8, 13, 14 & 16 (213 positions); sheet 3, column 2, line 11 (73 positions); sheet 4, column 2, lines 6 & 27 (5 positions); sheet 5, column 2, line 6 (15 positions); sheet 6, column 2, line 11 (196 positions) gives a total of 543 positions.

157. For purposes of ICC reporting, a carrier's workforce is divided into groups by type of employment: executive (Group I); professional and clerical (Group II); MOW (Group III); Maintenance of Equipment (Group IV); and Transportation (Groups V, VIa, and VIb).

158. See Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 1-6, EL App. N at 517-23; Kasher (S) (Nov. 1, 1979) at 26; Grotz (S) (Oct. 15, 1980) at 24-25; *Pennsylvania R.R.—Merger—New York Central R.R.*, 327 I.C.C. 475, 689 (1966).

159. See note 156, *supra*.

160. Application of a 10.4 percent attrition rate to the total number of El operating employees, as reflected in sheets 1-6 of Exhibit 16 to Shannon's deposition, produces the figures in Table 2. For example, addition of the figures (to the left of column 1) at line 10, sheet 1; line 23, sheet 2; line 14, sheet 3; lines 11 & 32, sheet 4; line 9, sheet 5; and

line 20, sheet 6, produces 9232 total EL operating employees. Thus, 9232 x 10.4% = 961, as appears in Table 2.

161. The figures in Table 3 are derived from Exhibit 16, at sheets 1 and 6, EL App. N 517 & 23. For example, examination of column 1 in sheets 1-6 indicates that 616 new jobs would have been created in year 1 in ICC Group III, Shannon (D) (Feb. 11, 1981) Ex. 16 at sheet 2, EL App. N at 518.

162. We do not attempt to reflect the attrition of employees from the surplus pool due to death. This decision reflects both the fact that this factor would have had only a small impact and the fact that an acquirer would have made a conservative estimate of its LPC liability.

163. Although a considerably higher proportion of Conrail employees chose monthly dismissal payments under the Rail Act, this experience is of little relevance to this case. While the Rail Act's provisions regarding monthly dismissal allowances, Rail Act § 505, are more favorable than those of the *New Orleans* benefits, there is little difference between the lump sum provisions of the two types of protections. Moreover, we believe EL would have both announced and demonstrated its ability to police the outside earnings deduction, thus making monthly dismissal allowances even less attractive. Our calculations are based on Shannon (D) (Feb. 11, 1981) Ex. 16 at sheets 28-35, EL App. N at 544-50, and the figures for average yearly compensation contained therein.

164. Grotz's figures indicate that even the less senior LV workers tended to have worked for the railroad for longer than five years. Thus, even those employees opting to receive dismissal allowances would have fallen primarily into the 5+ year category. Grotz (S) (Oct. 15, 1980) at Table 4, 5. See also I FSP at 164 (employees with less than five years service constitute less than 15 percent of railroad workforces).

165. The figures in Table 21 are derived from Shannon's workpapers, 999020-43, EL App. N at 628-39, and testimony, Shannon (S) (Oct. 15, 1980) at 21-22. For example, with respect to MOW, line 15 of 999020, EL App. N at 628, indicates a reduction in labor expenses of $240,525, which, when divided by the average MOW yearly salary, lines 7-8, reflects a reduction in employment positions in year 1 of 19 employees. Figures for Traffic and General departments derived from Shannon's testimony, *id.*

166. According to our calculations the ratio would have been 45 percent in year 1; 45 percent in year 2; 10 percent in year 3; and 0 in year 4.

167. Figures for total size of EL's nonoperating workforce derived from Shannon workpapers 999020-43, EL App. N at 628-39. For example, 127 MOW employees (999020, line 8), 93 maintenance of equipment employees (999023, line 7), 153 transportation employees (999027, line 6), 297 traffic employees (Shannon (S) (Oct. 15, 1980) at 21 (164 nonunion + 133 union = 297)), and 650 general employees (Shannon (S) (Oct. 15, 1980) at 21-22) provides a total of 1320, less 126 unprotected employees, leaves 1194.

168. Base period salaries derived from Shannon's workpapers 999020, line 30; 999023, line 29; and 999027, line 29, EL App. N at 628, 631, 635. Average protected employee's 1973 salary, based on these figures and adjusted upwards to reflect higher salaries of General and Traffic employees, see "Erie Lackawanna Railway Company, Black Book", Shannon (D) (Feb. 12, 1981) Ex. 26, EL App. N at 583, estimated to be $11,750. Adjustment for real increases in railroad wages, see Table 8, provides a 1975 salary of $12,320; a 1976 salary of $12,620; a 1977 salary of $12,920; and a 1978 salary of $13,230. Adjustments of these figures to reflect appropriate base period salaries, see Table 9, produces the following figures: 4/75—4/76, $12,419; 4/76—4/77; $12,719; 4/77—4/78, $13,022. No downward adjustment of salaries, as was used in Table 9, is applied in this context because the dismissal of a large number of nonoperating employees would have reduced the impact of seniority on the average salary of dismissed nonoperating employees.

169. Figures in Table 31 derived from Tables 24 (years 1-6) and 28 (year 7).

170. Grotz has held positions as Vice President of the Chase National Bank's Transportation Department and as President and Chief Executive Officer of Western Maryland Railway Company. Since 1969 he has been employed as a railroad consultant. Despite his extensive experience in the railroad business generally, he had never conducted a LPC study prior to submitting his statement in this case.

171. Our LPC calculations, which are based on Grotz's study, indicate that LV's LPCs pursuant to *New Orleans* benefits would be slightly larger than Kasher's projections for comparable benefit levels. This is

attributable to the different assumptions adopted by Kasher and Grotz regarding the numbers of employees who would have been dismissed because of the proffered transaction. Kasher's other projections of LV's total LPCs were substantially higher than Grotz's.

Grotz excluded employees aged 64 or older and nonagreement employees from his calculations. Grotz (D) (Jan. 24, 1981) at 462, 25 GP Supp. App. at 80. We accept his conclusion for several reasons. As in the case of EL, we think the number of nonagreement employees provides a fair estimate of the number of unprotected employees. Although LV would likely have incurred some costs as a result of requiring or encouraging, 2 GPRB at S 61, the retirement of employees aged 64 or older, we are aware of no evidence of the extent of these costs. In any event, we accept Grotz's treatment of this issue in an effort to reflect the reduction in LPCs that a 1976 acquisition date would have produced, see note 175, *infra.*

172. Alternatively, we think an acquirer would have applied a lower attrition rate—with much the same effect on LV's LPCs. For example, the average attrition rate for B&O in 1973 was 6.74 percent, Shannon (D) (Feb. 12, 1981) Ex. 23, EL App. N at 554, for C&O in 1973 it was 7.36 percent, Shannon (D) (Feb. 12, 1981) Ex. 24, EL App. N at 567 and for Norfolk & Western in 1973 it was 6.89 percent, Shannon (D) (Feb. 12, 1981) Ex. 25, EL App. N at 576. Either of these adjustments would have reflected an acquirer's reluctance to underestimate the difficulties and uncertainties, see pp. 125-26, *supra,* inherent in using attrition and rehiring to reduce LPCs.

173. The figures in Table 34 are derived as follows: 389 is taken from Grotz (S) (Oct. 15, 1980) at Table 2. The figure for year 2, 112, is obtained from Grotz (S) (Oct. 15, 1980) at Table 3, "Summary", lines 1-2: subtracting 2,015 from 2,161 leaves 146 and subtracting 34 unprotected employees, see *id.* at Table 3 n.6, assumed to come from earliest group possible, leaves 112. The same methodology has been applied to obtain the remaining figures in Table 34.

174. Distribution of employees choosing lump sum payments by years of service was obtained by calculating the percentage of employees in each of the WJPA categories, *e.g.*, 4/195 = .0205, see Grotz (S) (Oct. 15, 1980) at Table 8, and .0205 x 112 = 2.

Base period salaries used in Table 39 & 41 derived from Grotz (S) (Oct. 15, 1980) at Table 6, and adjusted to reflect real increase in railroad wages and fact that recipients would earn somewhat less than

average wage. *E.g.*, for 1975 salary, $11,800 x 1.0242 = $12,373; $12,373 x 95% = $11,754. This figure is then adjusted to reflect 4/75 – 4/76 base period: $11,847.

175. The LPC studies prepared by the parties did not attempt to quantify the effect of a later acquisition date on LPCs. Moreover, the record is devoid of evidence that would permit us to attempt such calculations, although we seek to reflect the effect of this factor in the bargaining between the acquirers and the Ts and in our estimate of the number of LV employees adversely affected by acquisition, see note 171, *supra*.

176. In 1968 PC estimated that its LPCs under the PCMPA would total approximately $78 million in the eight years following its merger with the New York Central Railroad. *Pennsylvania R.R.—Merger—New York Central R.R., supra*, 327 I.C.C. at 686. After only five years, however, PC had incurred LPCs of $116.3 million. Ex. GPS-Labor-4.

177. As noted earlier, p. 103, *supra*, the ICC generally has refused to impose labor protection conditions in cases involving complete abandonments. See cases cited in note 130, *supra*. Decisions to the contrary have occurred only infrequently and in unusual circumstances, such as a sale of abandoned lines for considerably more than scrap value, *e.g., Washington & Old Dominion R.R., supra*, 331 I.C.C. at 600-02.

178. Our timing analysis must include abandonments, as well as sales, even though the former may be a nonrail use issue according to the letter of the Second Pre-Trial Order. Similarly, we decide the timing of the PC and R dispositions, despite the penultimate paragraph of the Sixth Pre-Trial Order, since the disposition of all Ts are intertwined. None of the parties challenges this.

179. Under a "two-step" reorganization plan, each bankrupt would first dispose of its properties, with ICC approval, and then submit a plan for distribution of the proceeds, rather than submitting a unified plan in the first instance. See *New Haven Inclusion Cases*, 339 U.S. 392, 413 n.47 (1970). See also Blanchette (D) (June 19, 1979) 289-92, 9 GP Supp. App. at 21-23.

180. R appears to suggest that its disposition might have taken place under § 77(o), rather than §§ 77(d) and (e). Section 77(o) authorizes "interim" sales and abandonments, while §§ 77(d) and (e)

authorize sales and abandonments as part of a "final scheme of reorganization". For present purposes, the distinction between the two is not relevant, since the ICC would have had to scrutinize the sales and abandonments of rail use properties under either.

181. Sections 77(d) and (e) require that a reorganization plan be approved by the reorganization court after it is approved by the ICC. Blanchette testified that court approval of the decision to file with the ICC is also required. Blanchette (S) (Dec. 1, 1979) at 14. See also 2 ELF at 470 n.18. EL submitted, however, that court approval of the filing would be "virtually automatic". *Id.* Relying on this unrebutted assertion, we conclude that such approval, if necessary, would not have delayed the disposition process.

182. The ICC would, in fact, have evaluated the proposals under §§ 77(d) and (e) of the Bankruptcy Act, but these sections incorporated the standards of § 5 of the Interstate Commerce Act. *New Haven Inclusion Cases*, 399 U.S. 392, 425 (1970).

183. Evan Allen, Director of Rail Asset Valuation for USRA since 1978, had previously served as Senior Financial Analyst for the Southern Railway System and as Master Budget Accountant for Lockheed Aircraft Corp. Allen (S) (Nov. 1, 1979) at 1-2. Allen testified that it would have taken potential purchasers of IFLs two years or more to prepare the financial projections necessary to negotiate a memorandum of understanding. *Id.* at 4. William Quinn, a Director of the National Railroad Passenger Corporation (Amtrak), had been Chairman of the Board of the Chicago, Milwaukee & St. Paul Railroad, as well as President of the Chicago, Burlington & Quincy Railroad. Quinn (S) (Nov. 1, 1979) at 1-2. He testified that studies sufficient to support even tentative offers could not have been completed before February 1975. *Id.* at 4. Maynard Parks, a labor expert for the GPs, had worked in labor-related capacities in the railroad industry for over 40 years. He had served as Chairman of the Western Carriers Conference Committee and as Vice-Chairman of the National Railway Labor Council, and had been involved in negotiations with unions concerning several major rail acquisitions. Parks (S) (Nov. 1, 1979) at 1-2. Parks testified that an in-depth labor study relating to one of the IFLs would have taken at least a year. If more than one IFL were studied, more time would have been required. *Id.* at 17.

184. See, *e.g.*, Myles (S) (Nov. 1, 1979) at 14-26; Luna (S) (Nov. 1, 1979). Charles Luna is a Director of Amtrak and has been President

of both the Brotherhood of Railroad Trainmen and the United Transportation Unions. *Id.* at 1. Alfred Myles is a former Assistant Vice-President of Labor Relations for Chicago & Northwestern. Myles (S) (Nov. 1, 1979) at 1.

185. *E.g.*, Stangl (S) (Nov. 1, 1979); Altshuler (S) (Nov. 1, 1979); Schuler (S) (Nov. 1, 1979). Raymond Schuler is a former Commissioner of Transportation for the State of New York. *Id.* at 1. Alan Altshuler is Chairman of the Political Science Department and Professor of Urban Studies and Planning at MIT. Altshuler (S) (Jan. 31, 1979) at 1. Peter Stangl has been an Assistant Professor of Economics at Wheaton College, Assistant Transportation Administrator for New York City, and Assistant Commissioner for Public Transportation in the New Jersey Department of Transportation. Stangl (S) (Nov. 1, 1979) at 1-2.

186. *E.g.*, Brooks (S) (Jan. 31, 1979); Corber (S) (Jan. 31, 1979). Robert Corber served as a member of the ICC from March 7, 1975, to December 1, 1976, and had twenty-four years of private legal practice in the transportation field. *Id.* at 1-3. Robert Brooks was employed by the ICC for twenty-one years, and served as Director of the Commission's Office of Proceedings from 1974 to 1978. Brooks (S) (Jan. 31, 1979) at 1-4.

187. See Blanchette (S) (Dec. 1, 1978) at 10-11, 40-42; Shannon (S) (EL) (Dec. 31, 1978) at 93-94; Israel (S) (Dec. 31, 1978) at 21-22; Hesse (S) (R's Probable Actions) (Dec. 31, 1978) at 21-22. Robert Blanchette, who testified for PC, was, first, a trustee, then Chairman of the Board of Trustees, and finally Chief Executive Officer of PC during the mid-1970's. He had previously been Counsel for the Trustees and, before that, General Counsel to the New York, New Haven & Hartford R.R. Blanchette (S) (Dec. 1, 1978) at 1. Phillip Israel, a witness for LV, had served with the ICC for eighteen years in various capacities. When he left the ICC in 1977, he was Deputy Director, Office of Proceedings, Section of Finance. Israel (S) (Dec. 31, 1978) at 1. Alfred Hesse, Jr., had been associated with R for more than thirty-nine years, primarily in legal and marketing capacities. He became the President of R in 1977. Hesse (S) (R's Probable Actions) (Dec. 31, 1978) at App. 1.

188. The GPs do not contest that these Ts would have become cashless on these dates, assuming the absence of financial assistance, nor do they contest AA's cashlessness date.

189. As R points out, however, one GP witness testified that unaffected shippers would have pressed for speed. 2 RF at 245-246, *citing* Corber (D) (July 8, 1980) at 344, 8 R. App. Ex. 77.

190. Indeed, the GPs themselves assert that the threat of cashlessness is the core of the Ts' argument that labor and public bodies would have accepted unfavorable terms in the alternative scenario. 6 GP at U 2; 1 GPRB at C 1-2.

191. The *CUE Opinion* actually held that in the Rail Act world the government was permitted to "keep the railroads active for such a reasonable time as was necessary to effect a solution". *CUE Opinion*, 439 F.Supp at 1378. Because Congress was the prime actor in the solution, there was certainty that some solution could be found and that the Ts would be compensated for any damages in awaiting it. In the alternative scenario, however, where Congress by hypotheses could not itself take control of the Ts' lines, it is a fair extension of the *CUE Opinion* to allow the government to pursue a course of action that has a "high likelihood" of success within a reasonable time.

192. It might be argued that Congress could have avoided this danger by granting subsidies large enough to prevent erosion of creditors' rights. This argument is implausible, however, in view of the enormity of the cost. More important, such subsidies would create a stalemate, which Congress would eventually have to break. If continued indefinitely, they would have amounted to a purchase of Ts' properties by Congress under an installment plan—a forbidden "second-best Rail Act". *Cf.* RRB at 150 n.1.

193. Of course, postulating that Congress would have limited its financial assistance does not necessarily establish that reorganization courts would not have ordered some Ts shut down. Some courts, for example, might have considered the chance of successful sales too remote. We believe, however, that the sales would have gone through.

194. Aage Clausen is Professor of Political Science at Ohio State University. He is a member of the Council of the Inter-University Consortium of Political and Social Research, and Chairman of its Advisory Committee on Elite Studies. Clausen has published several articles on the policy decisions of members of Congress. Clausen (S) (Nov. 1, 1979) at 1-3.

195. Sections 213 and 215 of the Rail Act itself, 45 U.S.C. §§ 723, 725, provided aid, but it was limited in amount, and in duration as well

(until the date of conveyance). Of the legislation cited by Clausen that actually involved the commitment of federal funds, both the Transportation Act of 1958, Pub. L. No. 86-625, 72 Stat. 568 (amending 49 U.S.C. §§ 1, 13, 13A, 15A, 203, 501-510), see Clausen (S) (Nov. 1, 1979) at 18-19, and the Emergency Rail Facilities Restoration Act ("Hurricane Agnes" Act), Pub. L. No. 92-591, 86 Stat. 1304 (Oct. 27, 1972), see Clausen (S) (Nov. 1, 1979) at 26-27, were one-shot responses to specific needs. The High Speed Ground Transportation Act of 1965, Pub. L. No. 89-220, 79 Stat. 893 (1965), see Clause (S) (Nov. 1, 1979) at 19-21, provide funds for research and development by the Secretary of Commerce, not grants to carriers, and was limited as to both amount, Pub. L. No. 89-220 § 11, and duration, *id.* § 12. Although the Act was thrice extended, these extensions also carried time and expenditure limits. See Pub. L. No. 90-423, 82 Stat. 424, §§ (e), (f) (July 24, 1968); Pub. L. No. 91-444, 86 Stat. 915 (Oct. 13, 1970); Pub. L. No. 92-348 § 3, 86 Stat. 462 (July 13, 1972). The Rail Passenger Service Act of 1970 (Amtrak Act), Pub. L. No. 91-518, 84 Stat. 1327 (Oct. 14, 1970), see Clausen (S) (Nov. 1, 1979) at 21-23, provided guarantees on PC's obligations to stave off cashlessness. The authorized guarantees, however, were limited to $125,000,000. 45 U.S.C. § 662(e). While the Act could, nevertheless, be read to indicate a congressional willingness to pump needed cash into bankrupt railroads indefinitely, see *id.*, this is not the best reading. More likely, the Act was a stopgap, passed hurriedly in the last days of Congress, leaving the next Congress to devise a permanent solution if necessary. See H. R. Rep. No. 1770, 91st Cong, 2d Sess., *reprinted in* [1979] U.S. Code Cong. & Ad. News 5983, 5983; *id.* at 5987-88 (minority view). See also 116 Cong. Rec. S 44066 (Dec. 30, 1970) (remarks of Sen. Cotton); *id.* at H 43334 (Dec. 22, 1970) (remarks of Rep. Randall). In addition, Congress may have thought that a permanent legislative solution would never be necessary, that the railroads could be successfully reorganized after a single infusion of federal funds. See *id.* at S 44065 (Dec. 30, 1970) (remarks of Sen. Hartke).

196. See Northeast Rail Transportation: Hearings on H.R. 6591, H.R. 4897, H.R. 5822, H.R. 5385, H.R. 6880, H.R. 7373, & H.J. Res. 50 before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 93d Cong., 1st Sess. 231, 238 (1973) (remarks of Secretary Brinegar); *id.* at 251 (Statement of Jervis Langdon)

197. The GPs argue that consideration of such legislation in the alternative scenario is legally impermissible. 6 GP at T 219-222. They contend, first, that the Ts may not rely on changes in the law that were unforeseeable in February 1973. Second, they contend that the Ts may not add value to their property by claiming benefits that would have accrued from courses of action the government rejected or never considered, since the government did in fact enact a specific package of benefits, the Rail Act itself. Finally the GPs argue that the Ts may not assert that any of the procedural benefits of the Rail Act would also have been present in the alternative scenario. As to the first argument, it has been clear all along that interim aid was foreseeable. Congress would not have sat idly by while the Ts shut down. *CMV Opinion*, 445 F.Supp. at 1009. And it is inconsistent to claim, as the GPs appear to, that interim aid was foreseeable, but that congressional action to limit it was not. The other arguments are adequately addressed by noting that in the *CMV Opinion, id.*, we specifically permitted regulatory reforms to be taken into account. The only congressional actions that we removed from consideration there were the purchase of the Ts' lines or the equivalent underwriting of their continued operation into the indefinite future.

198. It should be noted that the Bankruptcy Code and Milwaukee Act are also of general applicability, see Milwaukee Railroad Restructuring Act, § 17, 45 U.S.C. § 1015, and thus could apply to larger transactions.

199. The Chessie Study itself took only three months to complete. White (D) (July 18, 1977) at 69, EL App. K at 240.

200. EL offers comparisons to several mergers that are not in fact comparable. See 2 ELF at 468-77. R states that the evidence shows public bodies could act quickly when necessary, and cites testimony of witnesses Hesse and Ronan. 2 RF at 224. But the evidence they cite does not bear them out.

201. One GP witness, Clausen, analyzed several statutes and concluded that federal aid would have been in the form of loans. Clausen (S) (Nov. 1, 1979) at 33. But the precedents cited are equivocal. In any case, the closest analogy is the Rail Act itself.

202. As to traffic protection, the GPs offer no evidence showing what conditions would have been imposed or what effect such conditions would have had on the earnings values of the T's lines.

203. For similar reasons, we also find it implausible that the ICC would have conditioned its approval on any solvent's acquisition of predominantly passenger lines, leaving it to the public bodies to operate the passenger service on those lines, see pp. 232-33, *infra*. Substantial doubt about the ICC's willingness, or even its power, to impose such a condition would have induced the public bodies to negotiate in earnest for the purchase of the passenger lines and operations long before the ICC reached its decision. Having thus "tipped its hand", a public body would have been unable to persuade the ICC to require solvent acquirers to buy losing passenger lines.

204. LV argues that the ICC had for many years denied that it had power to restructure the Northeastern rail system. LV at 27. This is irrelevant, since the witness on whom LV relies admitted on cross-examination that the ICC's denial applied only to proceedings it initiated. Israel (D) (May 14, 1979) at 88-89, 25 GP Supp. App. at 591-92.

205. We do not, of course, hold that any of this opposition would necessarily have been successful. Much of it most likely would not. For present purposes it is enough that all the Ts' dispositions would have encountered opposition, which would have slowed the process.

206. LV presented the testimony of Phillip Israel, Deputy Director of the division of the ICC that would have handled LV's petition. Israel (S) (Dec. 31, 1978) at 1-2. Israel stated that the ICC would have recommended against consolidating LV's application with the disposition of PC, in part because such a consolidation would be beyond the Commission's power. As Israel himself admitted, however, this reasoning was flawed. See note 204, *supra*. Moreover, as the GPs correctly point out, Israel's expert testimony is no more credible than the contrary view taken by GP witness Brooks. See 2 GPRB at U 21-22.

207. Shannon cited, as important examples of necessary "tag ends", completion of financing and "formalization" of sales contracts. Shannon (D) (May 24, 1979) at 575, EL App. K at 187.

208. Shannon (D) (May 24, 1979) at 575, EL App. K at 187.

209. See 2 ELF at 470.

210. LV did not conduct any passenger operations. It does not contend that its Aldene to Hunter segment, over which CNJ operated

passenger service, would have been treated by a public body as a passenger line. Rather, it was included with lines to be acquired by the JT owner, or, in the absence of the JTs, included with LV's freight lines in proffers for private acquisition. Response of the Erie Lackawanna and Lehigh Valley Trustees to the Court's Letter Dated September 24, 1981 Concerning "Predominantly Passenger" Lines in the North Jersey Terminal Area (Oct. 7, 1981) at 4, Sp. Ct. Rep. at N 37257.

211. This figure does not include the value of those portions of CNJ which the JTTs designated as part of the NJ/NYTerm. CNJ claims $100 million for its entire system.

212. An unspecified amount would have to be added to this figure for CNJ's main line, which the JTTs designated as predominantly passenger. PC also alleged an acquisition price of some $667 million for the rest of its Northeast Corridor properties from Massachusetts to Maryland, portions of which the JTTs also assumed would have been acquired by public bodies.

213. This figure in part represents the GPs' estimate of the excess of terminal costs over the terminal revenues that would have been collected from switching charges as set by the JTTs, as well as increased costs accruing from public body acquisition of the predominantly passenger lines and the Northeast Corridor Spine.

214. Many of these arguments apply to AA and CNJ as well.

215. See p. 233, *infra*.

216. As precedent for the JTs, the JTTs point to publicly owned terminal railroads in New Orleans, Galveston, Savannah, and Mobile. These, however, have an average length of only 48 miles of main line. By contrast, Philaterm would have comprised 114.2 route miles and the NJ/NYTerm 241.5. Compiled from Storm (S) (JT) (Dec. 15, 1978) App. C. These figures exclude an even greater amount of predominantly passenger lines that would also have been used for terminal operations.

217. In addition to the publicly owned terminal railroads mentioned in note 216, *supra*, the JTTs find precedent for public involvement in the rail freight business in the 1976 acquisition by the Massachusetts Bay Transportation Authority (MBTA) of certain lines of the Boston and Maine Railroad (B&M), and in the freight operations on the Long Island Railroad (LIRR) conducted by the Metropolitan Transit

Authority (MTA). See JTRB at 64. MBTA purchased 270 miles of the B&M's lines in and around Boston and entered into an operating agreement with B&M for the purpose of improving commuter service. See 2 CRA (S) (Dec. 1, 1978) at VI. While most of the trackage acquired consisted of commuter lines used jointly for freight traffic, a few lines which had been used exclusively for freight were also included. *Id.* at VI 58-65. B&M obtained trackage rights over all the transferred lines, with obligations to share maintenance costs on the jointly used segments and pay the full costs of maintenance on those used exclusively for freight. The acquisition of the freight-only lines apparently was made with the intention of expanding commuter service to them, a right which MBTA secured in the agreement. Although a GPs witness testified that a subsidiary goal of MBTA in effecting the transaction was to remove obstacles to B&M's attempt to reorganize as a freight carrier, see JTRB at 64, nothing about the transaction remotely suggests that MBTA was prepared to undertake freight operations on its own or even to subsidize B&M's freight operations.

The MTA's purchase of the LIRR was clearly for the purpose of maintaining passenger service, and its decision to continue freight operations hardly counts as evidence of the strong public commitment to upgrading freight service alleged by the JTTs.

218. This conclusion assumes that the main freight lines would have been sold for continued rail use. If it should turn out that the Ts would have dismantled their freight lines and sold them for scrap, our entire discussion of the acquisition of the JTs properties would become irrelevant.

219. LV's only segment carrying passenger traffic was not proffered for acquisition as a passenger line, see note 210, *supra*.

220. The GPs again question the permissibility of considering public bodies other than the federal government as potential purchasers. Although we indicated disagreement with their position in the *CMV Opinion*, 445 F.Supp. at 1037-40, we reserved final decision "to await factual development which will enlighten us as to the true dimensions of the issue". *id.* at 1040-41. Further consideration of the issue has reinforced our original inclination. It should be noted that public bodies' eminent domain powers do not diminish but rather enhance their bargaining position relative to the Ts, see pp. 235-36, *infra*. Moreover, there are built-in limits to any potential burden upon the federal government's condemnation powers. Consideration of public body purchases

is contingent upon a showing that acquisition would have been likely in the absence of the federal government's taking, and the amount of an award is limited to the amount the Ts can demonstrate that public bodies actually would have been willing to pay. In this sense, an award based upon a state's or municipal corporation's willingness to pay is no different from one based upon a private corporation's willingness to pay. Finally, there is nothing unusual about state law influencing the amount paid by the federal government in a condemnation proceeding since state law largely defines property rights. State regulations such as zoning ordinances diminish the value of some parcels of land and increase the value of others. In fact, the burden imposed by such public body action is less limited than that made possible by consideration of public body acquisition since the latter must be backed by the public's willingness to pay whereas the former is not. *Cf.* pp. 271-72, *infra.*

221. The GPs argue in the alternative that if consideration of changes in state law necessary for acquisition is to be permitted, then changes enhancing the power of public bodies in ways that might improve their bargaining position, for example, by authorizing quick-take condemnation, similarly should be considered. With this we agree as well, as intimated in our *CMV Opinion*, 445 F.Supp. at 1041.

222. The GPs' citation of T witnesses indicating that the absence of the Rail Act was itself unforeseeable as support for the proposition that requisite changes in state law were thus not reasonably foreseeable, 4 GP at Q 23-26, requires no extended discussion. The very premise of the alternative scenario, as in any condemnation proceeding, is that value is to be determined under the hypothetical assumption that the taking had never occurred. See pp. 32-33, *supra.*

223. For example, while EL's contract with New Jersey provided for a return on the net salvage value of facilities that would no longer be needed if passenger operations ceased to exist, it provided no return on facilities required for freight traffic even though used jointly by the passenger service.

224. This extended history of financial support culminated in 1978 with the State's purchase from Conrail of a substantial portion of EL's commuter lines under the Rail Act's 900-day option. The price, however, was much less than the $114.4 million EL seeks here. New Jersey paid only $8.8 million for the 125 miles of EL passenger lines it acquired in 1978. Compiled from Ex. PCT-NJ-100 at 02695, ELP App. 34.

225. 4 GP at P 86. *Cf. id.* at 70-71 (New York).

226. *Id.* at 79-80; see *id.* at 4-5; *id.* at 66 (section of argument described as reinforcing pricing conclusions). The GPs' reply brief provides a presumably exhaustive list of alleged impacts of their evidence concerning states' financial abilities, 2 GPRB at K 18-19. Frugal pricing policy receives first mention, followed by the claim that public bodies would first have pursued all alternatives to acquisition, discussed, *supra,* at pp. 207-11, contentions as to switching charges, *cf.* pp. 244-51, *infra* (trackage rights fees), and timing, see pp. 169-96, *supra,* neither directly relevant to this question, and the idea that public bodies would set priorities, buying only lines with high cost-benefit ratios, see also 6 GP at Y 9-21.

227. It is necessary that we include in this figure all public body lines, including those of Ts no longer in the case, unless it could be assumed that New Jersey would have purchased El's lines in preference to any of the others if funds proved inadequate. Since we find the State's capacity sufficient to purchase all the predominantly passenger lines, we need not decide precisely what the State's priorities among the lines would have been.

228. Even if current subsidies fully reimbursed shortfalls in avoidable costs, the Ts contend that public bodies would have assumed responsibility for the overhead costs on the predominantly passenger lines. The extent of the increased financial burden depends upon the trackage rights fees charged to freight traffic. See pp. 244-51, *infra.*

229. We do not mean to suggest that the GPs' estimates of incremental operating costs were accurate. EL hotly contest these figures, arguing that the operating cost shortfall in 1973 according to the GPs' own data was only $10.6 million, ELRB at 272-73, and that state acquisition would have enabled reductions in cost, ELP at 21-22, 26-27, discussed at p. 210, *supra.* In addition, the GPs appear to be implicitly double-counting since their estimates of operating costs include amortization of acquisition costs that the GPs present as a separate component of the financial burden. See ELRB at 273. Once again, because we find that the State could have paid even the higher figure, it is unnecessary to resolve the details of this controversy.

230. First Boston's table, First Boston (S) (Jan. 30, 1980) at 42, unlike the modified version reproduced by the GPs in a later section of

their brief, 6 GP at U 22, gives the impression that substantial increases in all three taxes are necessary to finance the operating burden.

231. In addition, First Boston's indication that the operating costs would consume 11.1 percent of the controllable budget, First Boston (S) (Jan. 30, 1980) at 43, translates, into approximately 4 percent of the total budget, again including the full $114 million of supposed added costs.

232. EL cites a 2.3 percent margin, ELP at 47 n.41, which, after incorporating the GPs' correction, 2 GPRB at K 33 n.57, yields a margin just under 3 percent.

233. The other two bond issues were not targeted to rail preservation and thus are a less useful guide to the most likely result in the absence of the Rail Act. EL's arguments noted in text apply to these proposals with even greater force.

234. EL's suggestion that cancellation of debt owed to New Jersey by the Ts would be an additional funding source, ELP at 58-59, is without merit. The GPs correctly note that to the extent the State ultimately expected to collect those funds, this source would be the equivalent of financing through general revenues, and to the extent it did not expect ever to collect those monies, cancellation of the obligation would hardly have provided any financial remuneration to the Ts. See Netzer (S) (Nov. 1, 1979) at 32-33; 2 GPRB at K 38-39.

235. The GPs' reference in this context to the "ultimately unsuccessful attempt to repeal the 1962 [Port Authority] bond covenant", *id.* at 31, is misplaced since the hypothetical sources of the toll revenues would have been in New Jersey, not under the jurisdiction of the Port Authority. The record does not disclose any similar limitations on the use of New Jersey toll revenues to finance the purchase of passenger lines.

236. See p. 174, *supra*.

237. *CUE Opinion*, 439 F.Supp. at 1377-78.

238. Of this amount, $4.2 million represented the training expenses for the approximately 1,000 employees engaged in the passenger service and the remaining $700,000 was accounted for by the costs of such items as the development of maintenance and safety procedures, work rules, and scheduling, pricing, and ticketing procedures. Shannon (S) (EL) (Dec. 31, 1978) at 92.

239. If, however, in the nonrail use phase, X should turnout to be so low as to not square with "notions of what constitutes 'just compensation' ", *CMV Opinion*, 445 F.Supp. at 1030, we would reconsider the question of whether a New Jersey court would have awarded a premium over X.

240. EL's evidence to the contrary, ELP at 62, 68-69, is far less persuasive. It is no surprise that the officials of the Port Authority whose testimony they rely on would be more fearful of the effect of the *PATH* decision than our analysis suggests. Stangl's testimony is a more reliable indication of perceptions of officials from New Jersey since he was an Assistant Commissioner of the New Jersey Department of Transportation and Secretary of New Jersey's Commuter Operating Agency. In addition, it is not clear that EL's evidence supports the award of a premium. For example, the memorandum prepared by a Port Authority official cited in ELP at 69 refers to "some significant compensation", which seems to draw on the *PATH* court's unwillingness to base an award on a nominal scrap value. And the recommendation of another Port Authority official that the State purchase at a liquidation sale in lieu of condemnation, see ELP at 62 n.57, hardly proves that the sale price would include a premium.

241. "Common basis" refers to appraisal values as determined by CRA. See 9 GP at APP. X 12, 123-31.

242. Although we could not decide that X and common basis are indeed the same until the nonrail use phase of the case, we need not defer decision as to the reliability of the CRA Study since we find that the Ts have not proved that consideration exceeded common basis.

243. In four transactions, in which no common basis could be arrived at, comparison was impossible; in one, common basis exceeded consideration; in another, the common basis figure included so great a range that CRA could not determine whether it was exceeded by consideration.

244. For example, in CRA's PATH case study, it failed to discover a valuation study, see J. Boyd (D) (July 31, 1979) at 24-26, 9 GP Supp. App. at 243-45, and did not review court testimony by one of the negotiators indicating the value of the properties, Dalton (D) (July 3, 1979) at 25-26 (PATH), 9 GP Supp. App. at 546-47; Ex. GPS-historical Transactions—118 at 28-30. Appraisals of properties involved in other transactions also went undiscovered, Wise (D) (June 8, 1979) at

126-27 (Cleveland), 21 GP Supp. App. at 716-17; Nelson (D) (June 28, 1979) at 67-68 (WMATA), 15 GP Supp. App. at 252-53. In yet another instance, CRA never obtained the purchase and sale agreement, presumably the most important document of all, Dalton (D) (June 11, 1981) at 101 (Skokie), 9 GP Supp. App. at 549.

245. For example, they interviewed only one of seven participants in the Long Island transaction, 2 CRA (S) (Dec. 1, 1978) at I 16 (listing participants); Lincoln (D) (June 11, 1979) at 89-94 (LIRR), 13 GP Supp. App. at 598-603, neither of the two most important in the B&M transaction, Burrows (D) (June 12, 1979) at 77-78, 9 GP Supp. App. at 427-28, and none of seven in the PATH acquisition, Dalton (D) (July 3, 1979) at 15-16 (PATH), 9 GP Supp. App. at 550. In one case, CRA did not interview the person it had been told was "the person to talk with," Burrows (D) (July 3, 1979) Ex. 30 (East End), 9 GP Supp. App. at 463; see CRA (S) (Dec. 31, 1978) at 94-108 (list of persons interviewed, which does not include Fred Morgan, the person identified), with the result that CRA apparently overstated noncash consideration by over 200 percent. *Compare* 2 CRA (S) (Dec. 1, 1978) at V 45-46 (quantifying operating subsidies at $175,000 for January to July 1973 as part of consideration) *with* F. Morgan (S) (Nov. 1, 1979) at 9-10 (indicating minimal increase in operating subsidy).

246. See, *e.g.*, D. Smith (D) (May 8, 1980) at 62-66, 9 GP at App. X33-34 (CRA researcher interviewed Donal Smith; at deposition Smith expressed shock at the method of inquiry and that his statements were used in litigation.)

247. In one case, CRA reported the view of the chief Penn Central negotiator, Burrows (D) (July 3, 1979) at 264-66 (East End), 9 GP Supp. App. at 449-51, ignoring those of two MBTA officials they had interviewed, see Burrows (D) (July 3, 1979) Ex. 29, 30 (East End), 9 GP Supp. App. at 461-63.

248. See, *e.g.*, J. Boyd (D) (July 31, 1979) at 31, 9 GP Supp. App. at 249 (Boyd insisting that a lease was not a lease).

249. This was the source of 60 percent of the $521.8 million consideration in the five transactions considered in Ronan's testimony.

250. For the acquisition of the Harlem-Hudson lines, CRA used $22.6 million, 2 CRA (S) (Dec. 1, 1978) at IV 42, whereas PC trustees had told the bankruptcy court that the amount was only $13.5 million, J. Boyd (D) (June 20, 1979) Ex. 2 at 8 (Harlem-Hudson), 9 GP Supp.

App. at 374. If PC's figures are correct, consideration was overstated by $91 million.

251. See 2 CRA (S) (Dec. 1, 1978) at III 32-38 (SIRT). No CRA evidence indicated that these past payments were in any way perceived by the parties to the transaction as consideration. See Nathan (S) (Nov. 1, 1979) at 26-27.

252. In the East End transaction, CRA included subsidy payments that were totally unrelated to the sale of the properties. F. Morgan (S) (Nov. 1, 1979) at 2-4.

253. See, *e.g.*, Prince (S) (Historical Transactions) (Nov. 1, 1979) at 6, 12 (within two years, passenger service would otherwise have ceased on the West End and Harlem-Hudson lines); Dalton (D) (July 31, 1979) Ex. 2 at 505 (Skokie) (ICC had expressed doubt that service would continue in the absence of the acquisition), 9 GP Supp. App. at 568.

254. See 9 GP at App. X 54-55. We have not been able to locate any evidence offered in defense of either the change or the ten times multiplier itself. Given the formula used to derive a multiplier, see CRA (S) (Dec. 1, 1978) at 50-51, it would seem that unlike the 4.31 factor, the ten times factor was not derived from a particular assumption concerning the number of years that deficits would continue, since such a calculation would not yield a round number. Rather, one might infer that the multiplier was chosen first, and then estimates of the underlying factual assumption concerning the number of years of future deficits were approximated by working backwards.

255. For some Staten Island Rapid Transit properties, a document indicated a value of $7.8 million as compared with a cash payment of $3.5 million agreed upon by the parties. See Caust-Ellenbagen (D) (July 3, 1979) Ex. 2, 9 GP Supp. App. at 493. See also pp. 225-26, *infra*, (ignored B&M appraisal); note 256, *infra*, (questionable LIRR appraisal).

256. An appraisal that was available to and relied upon by at least one of the parties valued the acquired properties at almost $87 million. 2 CRA (S) (Dec. 1, 1978) at I 22-29. The common basis actually used by CRA cut over $35 million from the land valuation, Seymour (S) (Dec. 1, 1978) at 3-6, 113, for reasons that are not altogether clear and for which support does not appear in the record. Most importantly,

there is no indication that any such adjustment was contemplated by either party to the transaction.

257. Ronan also ignored the dependence of earnings values on the Ts' main freight lines upon the passenger lines remaining in rail use, Ronan (D) (July 10, 1979) at 533, 17 GP Supp. App. at 591; Netzer (S) (Nov. 1, 1979) at 15-16. See pp. 231-33, *infra*.

258. D would be fully lost only if competitive bidding drove the sales price close to capitalized earnings value. It would thus be more accurate to say that the deduction should only be so much of D as would affect the purchase price. However, since we conclude that there would have been competitive bidding for EL-LV by Chessie and more than one Western bidder, see pp. 253-59, *infra*, we shall speak simply of a deduction of D.

259. Altshuler (S) (Nov. 1, 1979) at 7-10, 25 (Secretary of Transportation for Massachusetts, 1971-75); Whitehurst (S) (Nov. 1, 1979) at 29-30 (past consultant to various state and interstate transportation authorities; participated in developing and negotiating passenger subsidies for New Jersey); Netzer (S) (Jan. 31, 1979) at 46 (advisor to numerous public agencies); Stangl (S) (Nov. 1, 1979) at 19-20 (Asst. Commissioner for Public Transportation in New Jersey, 1974-78); Tennyson (S) (Nov. 1, 1979) at 6 (Deputy Transportation Secretary, Pennsylvania, 1972-1979); Comments and Recommendations of the State of New York on "Rail Service in the Midwest and Northeast Region", Rossi (S) (Dec. 31, 1978) Ex. 1 at 24-25 (New York's study of branch line contributions to profits as support for inclusion of all the State's branch lines in the FSP); Review of United States Railway Association Preliminary System Plan (Pennsylvania Department of Transportation), Ex. GPS-Public Bodies-142 at 15-16 (arguing that branch lines not contributing sufficient profits to Conrail might contribute sufficient profits to other railroads to justify their continued existence). The GPs' argument that public officials would have had reason to fear charges of bailing out the Ts through using public funds to boost the Ts' profits on the rest of their systems is also persuasive. See Altshuler, (S) (Nov. 1, 1979) at 15.

260. We here use the phrase "a passenger line" without determining whether EL's passenger lines are to be viewed separately or as a package—an issue discussed at pp. 238-39, *infra*.

261. Waldner (S) (Jan. 30, 1980) at 3-4 defines "exclusively" as "traffic originating or terminating at stations exclusively served by the public body lines". Traffic merely passing over public body lines or served by other lines must be excluded, see *id.* at 11 (indicating that the figure for all public body traffic would be 54 percent of revenues), since it could in principle be rerouted if the public body lines were abandoned. This evidence was not excluded by the order and stipulation discussed at note 14, *supra*.

262. El's response proves the point:

> The major failing of the above Government Party argument is that it implicitly assumes that a prospective solvent acquirer of the Transferors' main freight lines would have been willing to proceed with such an acquisition without prior assurances from the State that the State would acquire the Transferors' unprofitable passenger business. The fact is that no profitable carrier would have been willing to acquire the Transferors' main freight lines without such prior assurances from the State, and the State would have provided such assurances in order to induce a private acquisition of the critically important main freight lines.

ELP at 66 (citations omitted). In fact, the GPs' argument not only recognizes the interdependence of the transactions, but relies upon it to demonstrate that the Ts would have had no choice but to accept any offer in excess of X minus D.

263. See Netzer (S) (Nov. 1, 1979) at 8-9; Tennyson (D) (Mar. 19, 1980) at 156-59, 20 GP Supp. App. at 757-60; Altshuler (S) (Nov. 1, 1979) at 21-22; Jacobs (S) (Nature and Consequences) at 36-39; Prince (D) (Apr. 25, 1980) at 221-22, 16 GP Supp. App. at 765-66.

264. "Public bodies in the alternative scenario would have recognized [the Ts' aversion to following through on threats of a shutdown] and would have behaved accordingly." Altshuler (S) (Nov. 1, 1979) at 22. See also Ex. GPS-Public Bodies-186 at 8 (statement of R trustees upon review of SEPTA agreement) ("What the bondholders wish this Appellate Court to do is to require that an order be entered against the Trustees forcing them to play Russian Roulette with the public interest, with very poor odds."). Although Schelling noted that a T would have had "virtually nothing at risk in adopting any tactic that, should it fail, condemns [it] to recovering the nonrail use value of [its]

properties", Schelling (S) (Oct. 15, 1980) at 27, this comment is inapplicable to passenger lines for which D is significant since shutdown would risk loss of earnings values on the main freight lines.

265. Of course, when a T came back to the bargaining table to negotiate over what, if anything, of value was left of its system, it might be in a better position, but the cost it would have to suffer would have been too great, and, by comparison with the public body, the benefit would have been too small. Thus the factual predicate of what Schelling implicitly indicated to be a necessary condition for an effective threat is lacking. Schelling (S) (Oct. 15, 1980) at 24-25.

266. The Ts' bargaining power is further reduced by their relative inability to withstand delay, see Jacobs (S) (Nov. 1, 1979) at 20, which is due to both the dependence of the sales of their main freight lines upon disposition of the passenger lines and the interim operating losses they would suffer.

267. The GPs note that public officials would have been inclined to condemn in any event in order to shift responsibility for paying the Ts high prices to the courts. See, *e.g.*, Altshuler (D) (June 6, 1980) at 362, 8 GP Supp. App. at 662; Netzer (S) (Nov. 1, 1979) at 37 ("Payments by a public body of a premium because of [the] possibility [of a premium being awarded by a condemnation court] would subject public officials to great public criticism."). But it seems likely that a state would have paid a negotiated price if it would have been sufficiently low. Since the Ts do not contend that a state would have condemned passenger lines in lieu of paying a price based upon the GPs' pricing theories—and no historical evidence in the record indicates that such a result would have been likely—we assume that a state would have attempted to negotiate an acquisition at such prices.

268. The doctrine of setting off the value of special benefits conferred on the remaining parcel by the taking is followed in New Jersey. See 3 Nichols, *supra*, at § 8.6211[31].

269. The argument that no improvements were contemplated—just continuation of the same use to which the lines always had been put—RRB at 37-39, is without merit. The contention turns upon a formalistic interpretation of "improvement" that excludes from its meaning a state's rescuing the Ts' lines. "Improvement" is a relative term that in the takings context is addressed to the question of what would have happened but for the taking. It should be noted that any

interpretation to the contrary would have the necessary result not only of foreclosure set-offs for special benefits but also of foreclosing an award for damages to any remaining property in such situations. This much is implicitly conceded by R's citation of 3 Nichols, *supra*, at § 8.6201, RRB at 38, since the italicized portion in R's excerpt is immediately followed by a phrase indicating that special benefits "are ascertained according to the same principles as damages". Finally, if a formalistic approach were to be taken, it is not clear that the factual requisite to this attempt at distinction is present since a state would only have reason to perform the act of condemnation after a T's provision for abandonment were complete, at which point the use immediately prior to the taking would not be rail use.

270. The GPs' methodology is described in GPs' Sept. 14, 1981, Response at 17-21, Sp. Ct. Rep. at N 36872-76. Briefly, the GPs added revenues attributable to the Boonton and Suffern lines alone, multiplied the total by the excess of revenue over variable cost using a range of variable cost ratios, and capitalized the resulting annual figure using the methodology EL had used in its case. For the EL-LV Western acquisition, the figures range from $71 million to $213 million; for the EL-LV Chessie acquisition, from $83 million to $190 million, GPs' Sept. 14, 1981 Response at Table E, Sp. Ct. Rep. at N 36887.

271. In the context of the GPs' deduction argument, we find no merit in EL's excuse that the record is silent "[b]ecause of the Government Parties' 'all or nothing' approach", EL's Oct. 7, 1981. Response at 5, Sp. Ct. Rep. at N 37258. EL has conceded that the passenger lines contribute to the earnings value of the freight lines, and had ample opportunity to present evidence on the feasibility of rerouting in response to the GPs' claims.

272. It may not appear to go far enough since abandonment of the Boonton line would entail a substantial change in EL's and LV's overall operations in the North Jersey region and thus eliminate some fixed costs. For example, Jennison averaged full cost and variable expenses in estimating the impact of a 50 percent increase in traffic, which historically had moved over LV's system, on EL's line between River Junction and Buffalo. Jennison (S) (EL) (Dec. 31, 1978) at 19. But the revenue measure for the Boonton line refers to the revenue generated over the entire EL-LV system. This figure is large because a substantial portion of that traffic involves long hauls. Thus, in the event of abandonment, fixed costs along with variable costs would be eliminated over

the Boonton line itself, but fixed costs over the rest of EL's system would not be substantially affected. Thus the compromise ratio of 71.4 percent appears more reasonable, especially in light of EL's concession that the Boonton line was essential for any sale of its freight lines to a solvent railroad.

273. Purporting to be applying the statement in the FSP that:

> [w]here freight and passenger operations both use a facility, the dominant user should own the facility and bear all the costs of that facility except those which could be avoided if the minority user were not present.

I FSP at 40, which the Rail Service Planning Office approved, 43 F.R. 37693, 37696 (1978), pursuant to authority conferred in § 205(d)(5)(A) of the Railroad Revitalization and Regulatory Reform Act of 1976, 90 Stat. 59, 45 U.S.C. § 715(d)(5)(A), Shannon arrived at an annual figure of just over $700,000 as the appropriate trackage rights fee for EL movements over the passenger lines. The GPs ridicule this figure as being far too low, indicating, for example, that, under it, passenger service pays 7.9 times the amount charged to freight service on a car mile basis. GPs' Sept. 14, 1981, Response at 23-26 & n.21, Sp. Ct. Rep. at N 36878-81. The reason Shannon arrived at such a low figure was that his formula bore only the vaguest resemblance to that suggested by USRA. On lines where passenger traffic was dominant (over 50 percent on a car mile basis), he assigned *none* of the costs to freight. And on lines where freight was dominant, he assigned only 50 percent of the costs to freight, and even that was not 50 percent of the total cost, but 50 percent of the costs allocated to freight under the ICC's gross ton mile formula. Shannon (D) (June 21, 1979) Ex. 1 at workpapers ELR 300 206134-35. Thus, on predominantly passenger lines, some of which have over 85 percent freight traffic on a car mile basis, he assigned less than 30 percent of the maintenance costs to the acquirer of the freight lines. Shannon conceded that his estimate was equivalent to an avoidable cost freight charge, Shannon (D) (May 22, 1979) at 253, EL App. N at 82; see EL's Oct. 7, 1981 Response at 11-12, Sp. Ct. Rep. at N 37243-44, an allocation formula opposite to that suggested by the GPs' public body witnesses.

274. Technically, the analysis in text both here and later in the section when we address the ability of public bodies to extract additional earnings values through trackage rights fees, see p. 248, *infra*, is inaccurate in that the effect of taxes is not directly considered. Neither the

GPs nor the Ts raised this issue, and we need not consider it at length since it does not change any of our conclusions. The effect of taxes is to reduce the amount by which trackage rights fees diminish earnings values, which are after-tax figures, but to increase the ability of the state to extract additional earnings values by precisely the same amount. To avoid additional complexity in our discussion, we thus do not account for taxes at each step in our analysis.

275. The GPs' argument in no way indicates any threat to the sale of the freight lines unless trackage rights fees set to recoup D would drive the price solvent acquirers would have been willing to pay below the X for those lines. But this qualification is simply the mirror image to the above-noted reservation that deductions from the sale price of the passenger lines could not be so high as to drive the total acquisition price below X for the entire system. This discussion makes the assumption—consistent with the contentions of both parties and the dependence of sales of the freight lines resolution of the disposition of the passenger lines—that there effectively would have been three-party negotiations in each instance among the public body, the T, and the solvent acquirer, at which purchase prices and trackage rights fees would be determined. See *e.g.*, Hesse (S) (JT) (Dec. 15, 1978) at 30; Tennyson (S) (Nov. 1, 1979) at 6-7.

276. It is arguably more plausible that the trackage rights fee method of recovering D would have been chosen since otherwise solvent acquirers of the main freight lines, having already paid the Ts for the full earnings values, would be subject to additional extractions from the public in the future. By paying less for the main freight lines with the expectation that the state would charge trackage rights fees that would recover D, the solvent acquirers of the Ts' freight lines guarantee that they never will be subject to double payment. The GPs in oral argument note the seeming inconsistency between the Ts' insistence that no solvent acquirer of the freight lines would have considered acquiring even fully subsidized passenger operations on the ground that the public could not be trusted to continue the subsidies at the necessary levels in the future and the T's implicit assertion that the public could be trusted to keep the level of trackage rights charges at low initial levels. Tr. at 320-21. But there is a difference between a subsidy that requires renewed appropriations and thus appears on the debit side of a state's budget and a trackage rights fee based upon a predetermined formula for services rendered. In any event, the GPs have offered no basis for quantifying such a further deduction.

277. EL's $2,788,000 figure can profitably be compared to 56.2 percent of the unadjusted maintenance of way total of $4,775,000—$2,683,550. It is not surprising that the two figures are of similar magnitude since the former did represent a measure of freight's share of maintenance costs.

278. EL's assertion that such costs are already included in the trackage rights charge incorporated into their pro formas, EL's Oct. 7, 1981, Response at 16, Sp. Ct. Rep. at N 37248, is irrelevant since we are recomputing that charge and simply wrong since Shannon's $733,000 figure does not purport to include anything besides maintenance of way costs. See Shannon (D) (May 21, 1979) Ex. 1 at ELR 300 206134, 18 GP Supp. App. at 745. EL concedes as much in explaining the derivation of Shannon's figure earlier in its own statement. EL's Oct. 7, 1981, Response at 10-12, Sp. Ct. Rep. at N 37263-65.

279. The GPs object to our consideration of these proffers on the ground that LV's estimate of its own salvage value was so large that EL would never have accepted the balance of the total as adequate. We think it unlikely that if a sale of the combination would have produced the best result for both EL and LV, they would have foregone this sale because of inability to agree on a fair division of the proceeds. At oral argument counsel stated the two roads would have divided the proceeds on the basis of the relative net salvage values of the properties. Tr. at 67, 107.

280. EL includes, properly we think, Union Pacific as a potential bidder. Although in 1973 that road's eastern terminals were Omaha and Kansas City, it reached Chicago via a friendly connection with Chicago & Northwestern. Shannon (S) (EL) (Dec. 31, 1978) at 21.

281. In both instances, Chessie's disadvantage could have been alleviated by acquisition of R's class (a) lines.

282. Darling's attention had been attracted when he noted that EL had an unusually large car hire deficit, a situation which could be corrected by a road, such as Santa Fe, having adequate capital. This led him to go further. Darling (D) (Jan. 31, 1980) at 16-19, EL App. A at 93-96.

283. Barriger, as a GP witness, testified that Santa Fe had concluded not to pursue the acquisition for fear of possible retaliation. However, he conceded on cross-examination that this conclusion did not

describe what Santa Fe's attitude would have been in the absence of the Rail Act. Barriger (D) (Jan. 31, 1980) at 6, EL App. A at 105.

284. Noting this, Shannon proposed that the EL earnings predicted in the study should be adjusted upward in various respects. One was that the Chessie study used 1976 cost levels but did not take into account rate increases beyond October 11, 1975. A conservative assumption that a 5 percent increase would be in effect for the last three quarters of 1976 would increase annual pre-tax income by nearly $10 million. Shannon further adjusted for what he considered to be Chessie's overestimate of normalized maintenance of $10 million. Shannon also pointed out a mathematical error in the analysis of joint facility contracts which would have increased pre-tax net income by $4.2 million. The last adjustment is apparently non-controversial and the others were not controverted. As EL points out in its reply brief, ELRB at 20 n.12, the net result of these three adjustments is an increase of Chessie's figure for pre-tax income before fixed charge from $30.7 million to $54.8 million—as compared with Shannon's own figure of $53.7 million for the fifth year. Shannon believed that additional adjustments for deficiencies in the rerouting analysis and underestimates of traffic increases should have been made, but these were not quantified.

The GPs seeks to discredit the importance of the Chessie study by suggesting, 1 GPRB at F 13-14, that at a 20 percent discount rate, one of the alternatives posed in the Chessie study, the capitalized earnings of EL would have been only $34.5 million as against $52,936,444 proposed in the March 1, 1976, Green Book. However, the GPs have never proposed a discount rate as high as 20 percent; their witness Smith's figure was 10.45 percent. The Chessie study showed the results at discount rates of 0, 10, and 20 percent to indicate a range, without endorsing any specific figure. The GPs' argument also fails to take account of Shannon's adjustments, some of which, as indicated, do not appear to be disputed.

285. Barnett admitted that he had not studied EL's rehabilitation figures and, indeed, that he was generally unfamiliar with EL's case. Barnett (D) (May 30, 1980) at 56-57, EL App. H at 8-9.

286. Exhibit 8 to Shannon's testimony for EL is a letter dated January 27, 1975, from the President of the Missouri Pacific objecting to designation of PC east-west lines to Western carriers and stating that if this should be given serious consideration, "MoPac hereby suggests

and proposes that PC and EL segments be granted to MP either exclusively or as a participating owner and user as shown on the attachment." Unfortunately the "attachment" is not attached.

287. EL Map 3 shows how well the routes of EL-LV between Sterling and the Northern New Jersey terminal would have fit the Chessie system. In addition to providing a direct line between Chicago and New York in place of the multi-carrier route through Shippensburg, Pennsylvania, the acquisition would have given Chessie an effective route south of Lake Erie between Buffalo and Chicago, thus enabling it to abandon its operation across Canada. EL's branch between Warren and Cleveland, Ohio, would have shortened Chessie's route between Cleveland and the East.

288. The latter figure is for a Chessie acquisition of EL *and* LV.

289. Jennison is a Vice President of Wyer, Dick & Co. and has been associated with that company since 1961. Prior to that, he held several management positions with the Bangor & Aroostook Railway.

290. We have been particularly unimpressed by the adjustments to their study proposed by GP witness Scheer. Scheer (S) (Jan. 30, 1980). These were torn in shreds in EL's opening freight brief, 2 ELF at 319-37, and the GPs' reply brief made almost no effort to rehabilitate them.

291. Indeed, the GPs' criticism of Laurie for not having introduced more variables with respect to the changed ownership of other roads contrasts strangely with their objection to EL's having submitted four separate disposition proposals. 1 GP at A 69.

292. The figures for 1969-75 are as follows:

Year	Revenue Ton Miles
1969	15,505,454
1970	15,039,019
1971	13,786,020
1972	13,293,395
1973	14,206,262
1974	12,882,200
1975	9,562,398

Appendix H

Corresponding figures for LV are:

Year	Revenue Ton Miles
1969	3,140,579
1970	2,915,181
1971	2,474,872
1972	2,653,256
1973	3,230,572
1974	3,602,720
1975	2,911,924

R. Murphy (S) (Jan. 30, 1980) Apps. 6, 8.

293. The GPs also attack Shannon's estimate that traffic diverted from trucks in a Western acquisition, an addition to revenue that the GPs sharply question, could have been handled at a revenue ratio of only 60 percent. They assert that at the very least Shannon should have used Jennison's incremental ratio of 71.4 percent, which would have reduced annual net railway operating income by approximately $2 million. EL responds that the 60 percent figure is justified since small amounts of traffic are involved, to wit, a 1½ percent annual increase, the average length of haul is great, and there would be no interchange with any other railroads. It also cites ICC rulings that losses or gains of less than 10 percent of traffic would be accompanied by a 50 percent reduction or increase in related costs. See *Pennsylvania R.R. - Merger - New York Central R.R.*, 330 I.C.C. 328, 347-50 (1967); *Norfolk & Western R.R. - Chicago & St. Louis R.R. - Merger, Etc.*, 330 I.C.C. 780, 817 n.21 (1967); *Burlington Northern, Inc. - Control & Merger - St. Louis, San Francisco R.R.*, 360 I.C.C. 783, 1110, 1123 (1980) (47 percent of lost revenues would be saved by lowered costs).

294. EL also makes an extended argument to show that its application of system average switching costs in the EL-LV combination overstated rather than understated such costs. This is because the average, reflecting supposedly higher New Jersey costs, was applied outside New Jersey, whereas New Jersey switching costs were based on the JTs studies. In light of our conclusion with respect to the JTs, it is unnecessary to consider this argument. ELRB at 124-26.

295. Because of differences in the amount of property to be conveyed, these amounts differed as between the different acquisitions.

296. This yard was not included in the Chessie acquisition since Marion is west of Sterling, Ohio, where EL and Chessie connect. EL also points to testimony by Shannon, Shannon (D) (July 10, 1979) at 1096-1103, EL App. O at 487-94, that a Western acquirer could have achieved savings comparable to these contemplated for the reconstructed Marion Yard by using its own yards at or west of Chicago, without having to entail the capital costs estimated for the Marion Yard. However, Shannon conservatively took no account of this.

297. This yard was not included in the EL-LV combinations, since most of the service previously performed at Croxton would be performed by LV's Oak Island Yard.

298. In making this seemingly high estimate Shannon compared the location of EL traffic officers and those of Chessie, Norfolk & Western, and Santa Fe. Using a color coding, he found that virtually all EL's traffic offices were duplicative and that substantially all their work could have been done by employees of the purchaser. Shannon noted that his estimates of savings in traffic department costs were supported by the Chessie study. Shannon (S) (EL) (Dec. 31, 1979) at 84, *id.* at Ex. 13.

299. Moon is President of Albert E. Moon Analytical Services, Inc. He is the former director of Transportation Program Development in the Transportation and Industrial Systems Center of Stanford Research Institute.

300. Shannon's study was property-specific in the case of the traffic offices. We frankly doubt "the benefit of looking at the employees, offices or properties hypothetically merged" in the case of many of the overhead accounts. Looking at the chief executive of EL or at his office is hardly necessary to support the conclusion that in a merger he would have disappeared as such; the question is whether he might not have continued in some other executive capacity. Experience is a better guide on this question than visual inspection.

301. Wyer Dick also studied the Union Pacific - Rock Island merger, which never came to fruition, and the Louisville & Nashville-Chicago & Eastern Illinois merger, which went through on a radically reconfigured basis.

302. The GPs also quoted a 1972 report prepared by the Staff of the Senate Commerce Committee on the Pennsylvania - New York Central merger, which minimized the savings expectable in railroad mergers. EL, however, cited a much earlier report by the Senate Commerce

Committee, 86th Cong., 1st Sess., Report No. 445 at 244 (June 1961), saying that "[t]he savings in organizational expenses do not constitute the major areas of savings, but are perhaps the least controversial."

303. This was what Chessie did. As indicated, Shannon testified that Chessie's results were comparable with his own, and we have not discovered any contradiction of this. See Statement of the EL Trustee in Response to Court's May 21, 1981, Memorandum (June 1, 1981) at Part I, Sp. Ct. Rep. at N 35802-06.

304. Since none of the proposals for continued freight use advanced by EL involved the reconstruction of the Poughkeepsie Bridge, which would be essential to revival of the Maybrook gateway to New England or operation by the acquirer down the east bank of the Hudson, the much bandied about $100 million figure is illusory, except insofar as Rossi stated that "[i]nternally our position was that if Chessie insisted upon up to $100 million to make the acquisition as proposed in the Final System Plan, that money would have been committed", Rossi (S) (Dec. 31, 1978) at 8.

305. The EL-LV proposals involve converting most of the EL line east of Waverly from double to single track and using the LV line from Waverly to Newark to carry the bulk of the traffic between points west of Waverly and the Northern New Jersey - New York City areas. While the line through Port Jervis would be equipped with a modern signalling system and would remain capable of carrying substantial freight traffic, it may be doubted whether this is what Commissioner Schuler had in mind when he spoke of maintaining the Port Jervis line "as a main east-west freight line".

306. See Memorandum of the EL Trustees in Response to the Court's Letter of June 19, 1981, (July 10, 1981) at 6-7, Sp. Ct. Rep. at N 36159-60.

307. The GPs note the "brief time" allowed them to comment on the EL's July 10 submission. GPs' Response to July 10, 1981, Filings of Erie (July 24, 1981) at i, Sp. Ct. Rep. at N 36345. We do not believe that the two weeks allowed the GPs were insufficient. Given the essentially simple approach to the problem taken by EL, the paucity of criticism contained in the GPs' Response indicates to us that more time would not have profited the GPs significantly. More important, if the GPs believed they needed more time, they could have requested an extension as they have done on other occasions.

308. There is no inconsistency between this holding and our order with respect to evidence tendered by North Penn and Delaware & Bound Brook on October 15, 1980. See Memorandum and Order on Motion of GPs to Strike Direct Evidence Tendered on October 15, 1980, by North Penn and Delaware & Bound Brook (November 13, 1980), Sp. Ct. Rep. N 22612. In their initial evidentiary submissions, North Penn and Delaware & Bound Brook sought to show that their lines would have been acquired by a public body for a price based on their net liquidation value. Two years after the close of direct evidence from the Ts, North Penn and Delaware & Bound Brook sought to introduce evidence showing that their lines would have been acquired by a private railroad on the basis of earnings value. The evidence submitted covered a wide range of topics wholly unrelated to and heretofore unmentioned by the parties' initial witnesses. But for an ambiguous letter sent by the court in June of 1980, see Memorandum and Order of Nov. 13, 1980, *supra*, at 5-8, Sp. Ct. Rep. at N 22616-19, we would have granted the GPs' motion to strike this evidence. The differences between EL's position and that of North Penn and Delaware & Bound Brook are glaring. Rather than seeking to present a wholly new and inconsistent case relying on evidence unrelated to prior submissions, EL's July 10, 1981, memorandum discusses a contention previously endorsed by two witnesses and relies completely on materials already in the record.

309. For example, the cost of originating or terminating a TOFC in the JT's study was projected to be $124.99 per car. Under Jennison's study the historic cost was $89.59 per car for EL and $75.59 per car for LV. As a result of this and other adjustments, the total cost of operating EL's retained traffic fell from $234,983,000 in the EL-LV without JT Western acquisition to $229,371,000 when the JT assumption was abandoned. The total cost excluding overhead of operating LV traffic fell from $57,421,000 to $53,683,000. Workpapers to Memorandum of the Erie Lackawanna Trustees in Response to Court's Letter of June 19, 1981, (July 10, 1981) at 3-4. Similarly the total cost for the EL-LV Chessie acquisition fell from $165,716,000 to $160,130,000 for EL and from $50,083,000 to $46,343,000 for LV when the JT assumption was abandoned. *Id.* at 5-6.

310. EL and the GPs agreed to a great extent over how this adjustment should be made. The one point they could not resolve among themselves is whether revenues and costs associated with six particular traffic movements over LV's lines and certain other LV/CNJ revenues should be adjusted. We believe that EL's treatment is the correct one

since it is not proper to take out revenues and costs for traffic that were not originally included. See Reply of EL to GPs' Response to Court's September 24, 1981, Letter (Sept. 24, 1981) at 4-5, Sp. Ct. Rep. at N 37094-95.

The GPs also contended that additional New Jersey property taxes for the LV $403,000 should be included as a cost of operating the EL-LV lines and that maintenance of way expenses for the Phillipsburg to Port Morris lines should reflect the fact that that line is projected to be upgraded to a heavy density main line. We agree.

The GPs finally argue, GP's Response to July 10, 1981, Filings of EL at 8-9, Sp. Ct. Rep. at N 36352-53, that the points at which CNJ and EL-LV interchanged traffic would have been the subject of negotiation and that without determining those interchange points, the division of revenues between EL-LV and CNJ cannot be determined. The implication is that CNJ would have been able to lengthen its average haul at the expense of EL-LV. However, it is equally if not more likely that CNJ would have lost rather than gained in these negotiations since the combined EL-LV would have been a stronger competitor than either railroad had been individually. We assume, therefore, that the historic traffic patterns would have remained intact.

311. Applications to abandon operation of these ferries were pending before the ICC.

312. This segment included a 6.5-mile branch from Pittsfield to Saline, Michigan, to service a Ford plant. All references to the segment include the Saline branch.

313. The GPs also argue that the ICC would not have permitted any segmentation of AA. It may well be that AA would not have been entitled to abandon the losing segments if the Toledo-Ann Arbor segment produced a profit sufficient to cover the deficits on the losers and provide a fair return on the entire investment. However, no one contends that this was the case.

314. In light of our earlier conclusions, see pp. 282-86, *supra*, there would be no need for us to consider whether Michigan had the statutory capacity to acquire and operate rail lines. In any event an affirmative answer is compelled by the Advisory Opinion of the Supreme Court of Michigan, cited *infra*.

315. Although AA does not suggest this, some of the profits might remain available because of Michigan's ability to finance the purchase

at lower interest rates commanded by tax exempt securities as compared to those a private acquirer would have to pay.

316. It is significant that, in contrast to the parade of officials from the Northeastern States whom the GPs called to testify that these states would not have been willing to purchase Ts' freight lines, they called no official to give similar testimony with respect to Michigan. While AA likewise called no Michigan official, this was unnecessary in light of its documentary case.

317. The GPs do emphasize that with the Rail Act, Michigan pleaded to the federal government for funding, 4 GP at R 176-78, but for the reasons outlined previously, see p. 213, *supra,* such statements provide little indication of what a public body would have done if federal funds had been unavailable.

318. An example much discussed in the briefs concerns the shipment of cement from Dundee, Michigan, (on AA's Toledo-Ann Arbor segment) to Florida. While AA was under D,T&I's control, although AA could have carried this as far as Toledo, this traffic was carried by AA only to Diann, Michigan, where AA connected with D,T&I, thence over the entire length of D,T&I to points in Southern Ohio, and thence over the lines of other carriers to points in Florida. If an acquirer of one or more of the IFLs purchased AA, it would follow the same policy of obtaining the long haul. If all the IFLs were acquired by one purchaser as proposed in AA's initial case, it would have gotten the longest haul by carrying the traffic to Toledo and thence to Potomac Yard near Washington, D.C., where it would have turned the traffic over to the Richmond, Fredericksburg & Potomac R.R. From the standpoint of D,T&I it would be inconsequential whether a single purchaser acquired all the IFLs or a different purchaser acquired the Detroit-Cincinnati IFL. Either would have been in a position to divert much of the substantial traffic that AA had exchanged with D,T&I at Diann. See AA at 68-70.

319. We discuss below the GPs' argument that it is impermissible for us to consider an acquirer of IFLs.

320. Indeed, one of the GPs own witnesses with respect to AA, Evan Allen, had prepared a valuation study of a possible acquisition of D,T&I when he was a senior financial analyst for Southern, in which he included the value of revenues from D,T&I traffic that could be routed onto Southern's line. Allen & Kozu (D) (July 10, 1980) at 754, 1 AA Supp. App. at 19-21.

321. The GPs also contended that the diversion featured in Laurie's initial testimony, see note 318, *supra*, would not have been feared since the service via Potomac Yard would have been slower than that historically provided. Laurie effectively refuted this in his rebuttal testimony, Laurie (S) (Oct. 15, 1980) at 4-6, by showing, on the basis of timetables, that the time would have been the same.

322. See note 57, *supra*.

323. Laurie added, Laurie (S) (Oct. 15, 1980) Ex. 5 at 6, in line with Shannon's testimony, that the Seaboard Coast Line through its subsidiary, the Louisville & Nashville, was another possible acquirer of the Detroit-Toledo-Cincinnati segment and that if it succeeded in making that acquisition, it would have had an interest in the Ann Arbor-Toledo segment similar to Southern's and would have had roughly similar off-segment earnings. While this suggestion produces a second bidder for the Detroit-Cincinnati IFL, it does not add to the number of bidders for the Ann Arbor-Toledo segment.

If the diversion of southbound traffic on the segment to Potomac Yard was as important as Laurie's initial study indicated, we would suppose that a purchaser of the Chicago-Toledo-Cleveland-Buffalo-New York IFL might have an interest in the segment, but AA has not suggested this possibility and we shall disregard it.

324. The situation would be different if the Trustees of PC and AA had offered the Detroit-Cincinnati line and the Ann Arbor-Toledo segment as a package, but there is no evidence that this was ever considered.

325. The GPs attempt to weaken this, 1 GPRB at 3 n.4, by arguing that Wilmot uniformly disregarded potential diversions of traffic to PC lines because of his belief that these would be offset by potential losses and therefore "implicitly" credited the IFL with off-segment revenue by not deducting revenues that hypothetically would be lost. Whatever the merits of the argument might be in other contexts, *e.g.*, acquisition of an east-west line by a Western carrier where diversion of traffic to the acquirer might provoke retaliation by other Western lines, the GPs have not pointed out what retaliation D,T&I would have been in position to administer if an acquirer of the segment routed traffic to Toledo and thence to Cincinnati.

326. The force of the answer is diminished by the fact that, as owner of 99+ percent of AA stock, D,T&I was not truly concerned whether

the plant was served solely by AA of by itself as well. Much the same comment applies to PC, which owned 99+ percent of D,T&I.

327. We note in passing the inconsistency of the GPs' argument about the PC on this phase of the case and their objection, discussed above, to our considering the acquirer of a PC line as a potential bidder.

328. See note 289, *supra.*

329. Jennison states that his purpose was to permit Laurie "to estimate the impacts upon the profit levels of Penn Central and the Detroit, Toledo & Ironton Railroad that would have been associated with the abandonment of the Ann Arbor". Jennison (S) (AA) (Dec. 31, 1978) at 2. While this was a meaningful statement for D,T&I, except that Laurie contemplated not an abandonment of the segment but its acquisition by a competitor, it was meaningless with respect to PC, where the problem was to measure the cost of handling added traffic. Implicitly, Jennison assumed that the cost-revenue ratio for moderate amounts of lost traffic is the same as the one for moderate gains in traffic. Since the GPs do not challenge this assumption, we see no reason to question it.

330. The difference in the PC and D,T&I ratios is not due to the choice of different percentages or variability but to the relative importance of different accounts.

331. This was preserved by an order of Judge Thomsen, Laurie (D) (Feb. 3, 1981) 275, 278, 1 AA Supp. App. at 312, 313.

332. The figures come from AA's Quarterly Reports for Freight Commodity Statistics. They show a marked decrease in cement and auto parts origination in 1974 as against 1973 but a slight increase in American Motors jeeps.

333. Although the GPs had no opportunity to answer this argument in briefs, excerpts from the Quarterly Reports introduced in rebuttal would seem to be self-authenticating under Rule 902(5). Alternatively, all the reports may be subject to judicial notice under Rule 201.

334. The GPs also rely on a study made by Peat, Marwick, Mitchell & Co. for the AA reorganization trustee to determine whether AA could attain viability under any one of ten different configurations. One of these, and operation from Toledo to Whitmore Lake, only 9.5 miles north of Ann Arbor, is alleged to correspond closely to the Ann Arbor-Toledo segment. Peat Marwick's conclusion with respect to the viability of this operation, as of all the others, was negative. Laughlin (S)

(Dec. 31, 1978) at V 2-3. The GPs also cite a statement of an AA witness that Peat Marwick gave preliminary consideration to the Ann Arbor-Toledo segment itself but rejected this as less attractive than inclusion of the 9.5 miles north of Ann Arbor, Laughlin (D) (June 6, 1979) at 6, 13 GP Supp. App. at 431. AA's reply brief, AARB at 73-76, answers this in detail, pointing out significant differences in the assumptions underlying the Peat Marwick and the Laurie studies. The most important is that the Peat Marwick study assumed the operation of two daily sets of trains and crews, one between Whitmore Lake and Dundee and the other between Dundee and Toledo, while Laurie's study contemplated only one. We find AA's refutation persuasive.

335. L&NE points to a proposal made in 1972 by the LV Trustees, with the approval of the Attorney General of the United States, wherein the LV Trustees offered to pay $1,000,000 for L&NE's stock being held by the Attorney General and to guarantee $2.5 million in L&NE outstanding mortgage bonds, and the Attorney General also approved a credit of $5 million to be applied against the debt of L&NE's parent, CNJ, to the United States. This offer did not take account of the prospect of isolation of the Tamaqua branch. Moreover, it was subject to the approval of the LV and CNJ reorganization courts.

L&NE also submitted three offers made by private persons to the Department of Justice in 1975. The value of these offers, which assumed continuance of the Tamaqua branch and contained numerous conditions, is difficult to appraise, and L&NE offered no evidence (other than that contained in some of the offers themselves) as to the financial responsibility of the offerors. Moreover, the federal rule appears to be that a condemnee may not rely on offers to show market value. *Sharp* v. *United States*, 191 U.S. 341 (1903); see 4 Nichols, Eminent Domain, § 12.311[2] (1979). Although we would question some of Justice Peckham's reasoning in a case where the condemnee demonstrated the financial worth and *bona fides* of the offeror, these conditions were not met here.

336. According to Timpany, Sagner told him on July 24 that he had concluded not to proceed with a tender offer. Timpany (S) (Dec. 31, 1978) at 29. But on July 26, when Sagner requested the Peabody study, one of the questions he wanted answered was whether to make a tender offer. Stangl (D) (Mar. 25, 1980) Ex. 18, I CNJ App. at 424. Similarly, Goodstein, who, like Timpany, testified on CNJ's behalf, testified that Sagner was still considering that possibility on July 30.

Goodstein advised Sagner against it. Goodstein (S) (Dec. 31, 1978) at 7-9.

337. As we have noted elsewhere, the term "net liquidation value" has taken on something of a specialized meaning in this litigation, one that includes sales for rail use as well as scrap sales. See *In the Matter of the Valuation Proceedings*, 425 F.Supp. 266, 282; *CMV Opinion*, 445 F.Supp. 994, 1004. As the term is used here and elsewhere in CNJ's evidence, however, it refers more conventionally to scrap sale value of physical rail assets. However, even that term means different things to different parties, see pp. 28-31, *supra*.

338. These later events also suggest that Sagner's recollection of the July 18 meeting is far more likely to be accurate than Crane's since Sagner's action are inconsistent with his previously having made a detailed offer for CNJ's property.

339. They are:

a. $119,800,000: Goodstein's proposal of July 18 ($25 million cash plus assumption of obligations estimated at $94,800,000). Goodstein (S) (Dec. 31, 1978) at 7.

b. $117,907,000: New Jersey Department of Transportation's valuation of CNJ's net liquidation value as of 1974 adjusted to omit PC's half-interest in New York & Long Branch Railroad. Jacoby (S) (Dec. 31, 1978) Ex. 64 at 1.

c. $112,981,000: Peabody's valuation of net liquidation value as of December 31, 1973. Jacoby (S) (Dec. 31, 1978) Ex. 62 at ii.

d. $105 million: Timpany's proposal of July 26. Timpany (S)(Dec. 31, 1978) Ex. 18.

e. $100 million: Timpany's estimate in testimony of the probable sale price. Timpany (S) (Dec. 31, 1978) at 52.

f. $100 million: The bondholders' first suggested price at the March 21 meeting. Goodstein (S) (Dec. 31, 1978) at 5.

g. $80 million: Sagner's reported statement at the July 24 meeting that he "understood" the State would have to assume obligations. Timpany (S) (Dec. 31, 1978) at 29.

h. $79,654,000: Wyer Dick valuation of net liquidation value as of June 30, 1968. Timpany (S) (Dec. 31, 1978) Ex. 19, I CNJ App. at 29-34. Also adopted as a finding of fact by the United

States Secretary of Transportation. Timpany (S) (Dec. 31, 1978) at 52.

i. $71.5 million: Book value of the conveyed assets. Timpany (S) (Dec. 31, 1978) at 59.

j. $70-80 million: Sagner's estimate of net liquidation value at the August 23 meeting. Jacoby (S) (Dec. 31, 1978) Ex. 60 at 2.

k. $25 million over all prior indebtedness: The bondholders' second suggested price at the March 21 meeting. Timpany (S) (Dec. 31, 1978) at 5.

l. Fifty percent of the face value of the bonds: Sagner's suggested price at the March 21 meeting; estimated to result in $21 million over debt. Timpany (S) (Dec. 31, 1978) at 5.

340. Although CNJ suggests in its brief that Chessie had long been interested in CNJ, *e.g.*, CNJ at 155-57, there is no contention that anyone other than New Jersey would have bought CNJ for rail use.

341. We note, however, that most of the discrepancies between the JTTs' case and CNJ's proffer in the North Jersey terminal area concern CNJ lines not conveyed to USRA and, therefore, not part of this suit. Other discrepancies disappear by virtue of our rejection of the JT proposal, see Part XI.

342. Long before trial we warned the parties that:

> As at present advised, the Court is not disposed to entertain argument that any transferor would have obtained a strategic advantage over other transferors (as distinguished from such advantages as ending of deterioration, entitlement to interest, etc.) by negotiating or consummating a disposition at an earlier date than other transferors.

Second Pre-Trial Order at 4, Sp. Ct. Rep. at N 11801-02. We have since remarked that:

> While, as indicated by the language, that view is not frozen in stone, we could not properly depart from it without being fully advised of the effect of such a departure on the Government Parties and other transferors.

Memorandum and Order of April 23, 1980, at 4, Sp. Ct. Rep. at N 20242. There is room for debate as to whether CNJ's proffer violates the letter or spirit of these admonitions. Nevertheless, the point is moot. The only "strategic advantage" CNJ might have garnered from its timing contentions would be a favored position for certain CNJ properties as compared with other Ts' properties—for example, a conclusion that, because of CNJ's early disposition, New Jersey would have acquired CNJ's Phillipsburg-to-Newark line rather than LV's parallel line. Since we have already concluded (without considering the effect of timing) that all of CNJ's properties would have been purchased for rail use, it is unnecessary to decide whether CNJ may invoke its timing allegations to establish that point.

343. CNJ devotes several pages of its brief, with quotations from and citations to the evidence, to its contentions concerning LV, R, and EL. CNJ at 121-24. In contrast, its sole statement concerning PC is this: "Whether PC was truly ready to seek to liquidate (in view of the risks of traffic diversions by the other Transferors, the views previously noted of the Federal Railroad Administration, its own views of a profitable core, and the downside risks of a liquidation elaborated in the CUE Opinion) *is an interesting question.*" CNJ at 124-25 (emphasis added).

344. CNJ asserts that the State had encouraged the bondholders to seek a total shutdown in December 1972. CNJ at 131. The evidence cited for the assertion, however, is only the conclusory impression of Roger Ward, a bondholders' representative, Ward (S) (Dec. 31, 1978) at 24-25, II CNJ App. at 167-68; it is not backed up by any alleged oral or written statements by any State official. Moreover, even if the State did give such encouragement, it did so only in contemplation of a purchase of CNJ by LV and R. There was no prospect of such a purchase in the fall of 1973.

345. Indeed, CNJ goes so far as to request us to find that even without any sale of rail use CNJ would have realized $100 million in actual liquidation for scrap. CNJ at 163.

346. In light of the pending settlement between the GPs and EL, we, of course, do not expect EL to petition for reconsideration nor do we expect the GPs to raise issues relating solely to EL. If the settlement should not be approved, we will entertain applications for reconsideration for EL and from the GPs in respect of El.

APPENDIX I

Appendix 1

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

FILED JAN. 25, 1982 JAMES F. DAVEY, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER SECTIONS 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

Opinion on Petitions for Reconsideration of Rail Use Opinion

PER CURIAM:

We deal in this opinion with petitions for reconsideration of our Rail Use Opinion dated November 24, 1981, which were filed on December 29, 1981, by the Trustee of the Lehigh Valley Railroad (LV) and the GPs.[1] We called on the adverse parties to answer these petitions on January 11, 1982.

THE LV PETITION

A. *Valuation Methodology*

The LV petition raises three points concerning Part VII of the opinion entitled Valuation Methodology. These are (1) that "the conservative assumption in the EL-LV pro forma that there would be no growth in cash flows after the terminal year should result in a lower cost of equity than 20%"; (2) that the inflation factor used by the Court in deriving the discount rate was understated; and (3) that use of the DCF methodology requires that

1. A petition for clarification or reconsideration filed by the Trustee of the Ann Arbor Railroad on December 23, 1981, Sp. Ct. Rep. N 38766, has been determined by an order dated January 11, 1982, Sp. Ct. Rep. N 38958.

the EL-LV cash flows be restated to account for tax savings resulting from depreciation. We find no merit in any of these points.

(1) LV's argument is that in using a 20% cost of equity for EL-LV, which was derived in part from PC witness F. Smith's figure of 22.5% for the IFLs, we failed to take account of the fact that whereas Smith's cash flows were projected to increase after the terminal year, to wit, 1985, at an annual rate of 2%, witness Shannon did not include any growth in the EL-LV traffic base after the fifth year.[2] This, LV argues, is an element of conservatism which should be reflected by a reduction in the cost of equity to 19%.

Apart from other considerations, this claim shatters on the rock, pointed out by the GPs (Answer, pp. 5-7), that Shannon's projections for EL-LV were actually less conservative than those for the IFLs. The projections for the IFLs were stated in nominal dollars and, as LV correctly points out, contained the assumption that revenues, in nominal dollars, would grow at a 2% rate. When combined with the effect of long-term inflation, which the parties generally projected to be from 5-6%, see GPs' Answer, p. 6, the *real* cash flow was not projected to keep up with inflation. See Myers (S) (PC) (Dec. 1, 1978) at 15; F. Smith (D) (Aug. 22, 1980) at 1818, 19 GP Supp. App. at 346. In contrast, the EL-LV projections, which were stated in real dollars, assumed that cash flow would remain constant in real terms. Thus the El-LV projections were in this respect riskier than those for PC since EL-LV assumed that cash flow would keep up with inflation.

(2) LV's second point is that we erred (Opinion at 66) in using 5.58% as the factor for deflating the 15.22% nominal AWCC to derive a real AWCC of 9.13%. The 5.58% figure was the arithmetic average of the yearly inflation rates forecast by Dr. Olsen for the IFL projections. Smith (S) (GPs) (Jan. 30,

2. LV adopted all of EL's evidence dealing with the EL-LV combination. See LV Summary of the Testimony (Dec. 31, 1978) at 2-3, 25; LV Opening Brief at 8.

1980) at 154-55. These rates were 6% for the period 1974-80 and 5% for the period 1981-85. LV's argument is that since Shannon's projections were made for only five years, we should have used Dr. Olsen's 6% figure.

This contention ignores the nature of a capitalization of earnings on the discounting of cash flows. Even when only the terminal year's figures are selected, the assumption is that these will continue. As the GPs put it (Answer, p. 11), "[c]apitalization of the fifth-year earnings for EL-LV has the obvious effect of extending the projections in perpetuity."

(3) LV's third claim is that in translating the Shannon pro forma forecasts of earnings for the fifth year of operations into forecasts of cash flows, the court erred in using Shannon's estimates of depreciation rather than what LV contends would have been higher figures that would have been used in a cash flow analysis. The argument is that "both the buyer and seller of EL-LV, in determining the most they would be willing to pay and accept, respectively, would have determined the most that the buyer could get from the property" (Petition, p. 12); that in an earnings analysis this would be achieved by using the lowest depreciation rates consistent with generally accepted accounting principles; but that in a cash flow analysis the acquirer would adopt the highest rates permitted under the income tax laws since depreciation is not deducted from cash flow but higher depreciation will result in lower taxes. Also, under an earnings analysis, the purchase price will be allocated to nondepreciable assets so far as permitted by the contract and generally accepted accounting principles; *per contra* when the analysis is on a cash flow basis. LV has filed with its petition for reconsideration twelve pages of new calculations which purport to demonstrate that the latter adjustment alone would enhance the EL-LV cash flows for a five year period by $19,735,000.

We agree with the GPs that this contention comes too late. The GPs argued in their initial submissions that cash flow rather than earnings constituted the proper valuation methodology, F.

Smith (S) (Jan. 31, 1979) at 19-23, as indeed PC had also done, Hallingby (Dec. 1, 1978) at 21. This has always been a major issue in the case. See Opinion at 49-55. LV could not simply sit back and assume that the court would decide in favor of the capitalized earnings method. Indeed, our letter of June 19, 1981, Sp. Ct. Rep. N 36204, expressly requested EL and LV to provide us with cash flow projections based on their pro forma earnings statements, and they did. If LV considered that lower figures for depreciation ought to be used should the court opt for the cash flow method, it was bound both to raise the point and to quantify it by presenting calculations which the GPs could challenge. The GPs question many of the assumptions and computations which LV makes in its present effort to show that larger depreciation deductions would have greatly increased EL-LV's after tax cash flow. We do not reach such questions since, as a result of LV's failure adequately to raise the point that it would have had higher depreciation deductions and consequently lower income taxes on a cash flow method during the trial or even during the post-trial submissions (Opinion at 15), the record is not adequate for us to decide them.

B. *Labor Protection Costs*

LV also asks us to reconsider three aspects of Part IX of the opinion, relating to Labor Protection Costs.

(1) *Pre-Day One Attrition.*

The first is our refusal to take account of "pre-day one attrition" (*i.e.*, attrition prior to the conveyance date) beyond the six month period reflected in Table 35, Opinion at 156. This was a considered decision made partly in the interests of conservatism, Opinion at 163, and partly because, as stated in note 175, p. lii, "[t]he LPC studies made by the parties did not attempt to quantify the effect of a later acquisition date on LPCs" and the record was "devoid of evidence that would permit us to make such a

calculation . . . ." We see no reason to depart from that decision. LV's own witness, W. Arthur Grotz, made no allowance for pre-day one attrition, Grotz (S) (Oct. 15, 1980) at 13-14; Grotz (D) (Jan. 22, 1981) at 186-87, in part because he thought that LV would need its quota of employees to run the railroad until the ICC permitted abandonments. Grotz (D) (Jan. 22, 1981) at 125-26, 723; Ex. GPS-Grotz-Labor (X)-16, 25 GP Supp. App. 122P, 251A. While LV might have been able to persuade a prospective purchaser that pre-day one attrition would have produced lower LPC's than those estimated in our Opinion, we find no basis in the record or in good sense for thinking that this would have been of an order of magnitude approaching the 50% which LV now asks us to adopt.

(2) *Transfer of Displaced LV Employees to Parallel EL Lines in New York*

LV urges that Grotz's estimates of displaced LV employees were based on a LV "stand-alone" hypothesis and require adjustment in light of our conclusion that the most likely outcome for LV was to sell its lines east of Waverly, N.Y., as part of an EL-LV purchase. The employees on the abandoned lines west of Waverly, LV alleges, would simply have moved over to the "parallel" EL lines in order to handle the traffic contributed to those lines by the LV lines east of Waverly. Shannon gave brief testimony to this effect. Shannon (S) (Oct. 15, 1980) at 15. In support of this LV points to our acceptance, Opinion at 141, of EL's contention that employees surplussed as a result of abandonment of its Scranton line would move over to LV's Waverly-Newark line.

We note initially that, notwithstanding his unexplained statement to the contrary, Grotz's estimate of the number of positions that would have been required to operate the LV system on Day One is applicable to the EL-LV acquisition as well as to the LV stand-alone case. Grotz testified that he derived his estimate of the manning requirements of the LV system from "the actual

employment of former LV personnel by the Trustee after conveyance to Conrail in 1976". Grotz (S) (Oct. 15, 1980) at 16. He justified this methodology on the ground that "LV contends that *the same properties would have been kept in rail use* absent the Rail Act as were in fact conveyed to Conrail". *Id.* (emphasis added). On this theory, however, Grotz's conclusions regarding manning requirements in the LV stand-alone case would be equally applicable to the EL-LV acquisition, since, as the GPs point out (Answer, p. 23), there was virtually no difference in the "properties [that] would have been kept in rail use". Thus, the Opinion's reliance on the Grotz study in calculating the number of employees that would have been required to operate LV's lines in the EL-LV acquisition was proper.

There remains, however, the question whether the Court improperly relied upon Grotz's treatment of the possibility of the transfer of LV's New York State employees to EL's lines. Grotz did not think, as Shannon did, Shannon (S) (Oct. 15, 1980) at 15, that LV's New York State employees would be transferred wholesale to EL's New York lines, but instead testified that these employees would have been rehired into attrition-opened positions in the LV system, Grotz (S) (Oct. 15, 1980) at 16, 24, 31-32. On the other hand, Grotz's testimony was addressed to LV's "stand-alone" case and there is no indication that he focused on an EL-LV package.

LV's Petition thus raises a legitimate point. In most of the parties' discussions of LPCs, the Ts were treated largely as individual units. After we accepted the EL-LV package, however, the possibility arose of two Ts, *i.e.*, LV and EL, cooperating to reduce one another's LPCs, and Shannon did testify, although only in a conclusory fashion, on the issue now raised by LV.

We think that in EL-LV's negotiations with an acquirer some allowance would have been made for the possibility of cooperation between EL and LV to reduce total LPCs. The acquirer, of course, would not have accepted arguments based upon a premise that vacancies in one system would be filled by employees from

both systems, which would be a form of double-counting. In addition, because of possible difficulties—relating, for example, to geographical restrictions, union restrictions and timing considerations—in effecting "inter-corporate" transfers, we think potential acquirers would have demanded an extremely conservative approach to this issue.

Based on the foregoing considerations, we believe that only a limited number of LV's New York State employees would have been transferred to EL's parallel lines. We think an acquirer would have been willing to treat roughly a third of the 299 LV Maintenance of Way, Maintenance of Equipment and Train and Engine employees in New York State as able to find work on the EL lines. This would reflect an acquirer's uncertainty regarding "inter-corporate" transfers. Moreover, it would permit a rough equivalence of transfers between EL and LV, thus avoiding the need to "settle accounts" between EL and LV, since in the Opinion we decided that 90 EL employees would find work on LV's lines, Opinion at 141. We conclude therefore that 90 LV employees would also have found work on EL's lines. This requires reducing the figures for 4/76 in Table 37 from 281 to 191, and, following this change through Tables 38-42, results in subtracting separation payments, dismissal allowances, and fringe benefits attributable to these employees from our calculations of LV's LPCs. The parties should have no difficulty in making these calculations. If this conclusion still is less favorable to LV than our corresponding treatment of EL, a sufficient answer is that the latter was unchallenged.[3]

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3. Beyond this there would have been greater ease of transfer for EL employees. Although the surplussed LV employees were based primarily in Sayre, Pa., and Buffalo, N.Y., there would have been some problem with respect to the Buffalo employees since no former LV traffic would move over EL's Buffalo branch. Shannon appears to have conceded in his deposition that LV's Buffalo employees would require special treatment, Shannon (D) (Jan. 15, 1981) at 707; when he was pressed on the issue, it became apparent that he had made no detailed study of LV's operations in the Sayre-Buffalo area, *id.* at 704-07, 720-22.

(3) *Dismissal Allowances*

The Opinion decided that the labor protection benefits that would have been accorded the Ts' employees would have been reached through negotiations and would have been based roughly on the pattern of the New Orleans conditions, Opinion at 114-18. LV's final point with respect to Part IX of the Opinion is that we "departed from [the *New Orleans*] pattern in certain significant respects". Petition, p. 26. Although LV's observation is correct, that departure was the result of a considered decision. As our discussion of the *New Orleans* conditions, Opinion at 117, indicates, we were well aware that those conditions provided only for "residual" WJPA benefits in the fifth year following acquisition. However, as emphasized, Opinion at 117, we said only that the labor protection bargaining process "would have settled on levels of labor protection *roughly equivalent* to the *New Orleans* conditions", (emphasis added), and that the parties would have reached a "compromise based *roughly* on historical levels of labor protection". *Id.* at 116 (emphasis added). We similarly departed from or added to the *New Orleans* conditions with respect to non-union employees and an acquirer's transfer rights. *Id.* at 117-18.

Thus, while occasionally we used the terms "*New Orleans* conditions" and "WJPA conditions" as shorthand references, our calculations were based upon an intentionally simplified form of the *New Orleans* conditions, *e.g.*, Opinion at Tables 28 & 40. We recognized that this increased the Ts' LPCs, yet thought this consistent with the general historical trend towards increased labor protection benefits, discussed in the Opinion at 114-15. We see no reason to alter our original approach.

C. *Trackage Rights Fees*

In section XI.B.5 of the Opinion, we recalculated the trackage rights fees that would have been charged by the public acquirer of EL's New Jersey passenger lines to the private acquirer of the

EL-LV combination, so as to change this from EL's figure of $733,000 per annum to $3,097,888. Opinion at 247-51. LV claims that our estimate of the maintenance component of the trackage rights fees overstates the total costs that would have been borne by a private acquirer.

The initial step in LV's argument is that the court erred in rejecting the $4.3 million maintenance cost figure contained in the study of EL passenger avoidable costs for 1973, Opinion at 249-50. In light of LV's explanations, which the GPs do not contest, we agree.

It follows that Shannon's assignment of $4 million in maintenance costs to the public acquirer of the passenger lines was not excessive since New Jersey had already been paying $300,000 more. Since LV does not contest that passenger service would only have borne approximately 44% of the total maintenance costs for the passenger lines, a $4.3 million share for the state suggests that the total is approximately $9.8 million. Thus the maintenance costs properly chargeable to the freight acquirer through trackage rights fees would be the difference between $9.8 million and $4.3 million, approximately $5.5 million. At first blush, as contended by the GPs (Answer, pp. 31-32), this would justify an upward rather than a downward revision of the trackage rights fees. However, LV argues that the trackage rights fees should be revised downward because the difference between this higher total maintenance cost, $9.8 million, and the total maintenance cost assigned by Shannon for both freight and passenger operations over the passenger lines, approximately $4.8 million, has already been charged to the acquirer of EL-LV. The reason is that Shannon computed the maintenance costs over the freight lines by subtracting his $4.8 million estimate for maintenance costs over the passenger lines from the total reflected in EL's 1973 Form R-1 as adjusted for normalization. Thus, if maintenance costs over the passenger lines should be figured at $9.8 million, rather than $4.8 million, the deduction of the higher figure from Shannon's estimate would result in maintenance costs on the

freight lines being $5 million lower than assessed to EL-LV. Any upward adjustment in trackage rights fees would thus be accompanied by an equivalent diminution of maintenance costs on the freight lines.

LV's argument incorrectly assumes that in accepting EL's maintenance estimates for the freight lines over those of the GPs, Opinion, Part VIII, at 101, we endorsed the methodology behind EL's figures. We were not approving as adequate Shannon's adjustments in EL's 1973 maintenance costs to bring them to a "normalized" level, see Opinion at n.112, since the factual basis for computing the magnitude of those adjustments was not set forth in his testimony. Rather, the Opinion at 101 noted that the GPs' maintenance cost estimates, although far more reliable than their rehabilitation cost estimates, were overstated to some unquantifiable extent. Since the GPs' and EL's estimates were reasonably close, we accepted the latter. This conclusion derived support from the comparison of EL's rehabilitation and maintenance estimates with those contained in the Chessie Study, Opinion at 86-87. Although the Chessie study was not as detailed as that performed by EL, we regarded it as a sound basis for comparison because it was performed by a potential acquirer. We did not find the fact that EL's 10-year total for maintenance and rehabilitation cost was only 85% of Chessie's estimate to be a sufficient basis for discarding EL's figures. However, the GPs point out, Answer, p. 30, that the reduction in maintenance costs on the freight lines implicit in LV's new claims suggests that EL's 10-year total for rehabilitation and maintenance costs on the freight lines is only on the order of 68% of that suggested by the Chessie Study[4]—a divergence of over twice the magnitude originally contemplated. We surely would not have accepted an estimate so much lower than that in the Chessie study. In sum, we

4. The Chessie Study did not include the rehabilitation and maintenance costs for EL's passenger lines. See Shannon (D) (July 10, 1979) Ex. 36 at 1, EL App. B at 201.

accepted Shannon's estimate for what it purported to be, a forecast of maintenance of way expenses on EL's freight lines—not, as LV would now have it, of such expenses plus an additional amount for freight service over the passenger lines.

While we do not totally reject LV's suggestion that what appears to be a newly emergent consensus between the parties on a far higher estimate of maintenance costs on the passenger lines may not imply that maintenance costs which Shannon allocated to the freight lines were somewhat too high, it is too late in the day to undertake the development and analysis of new studies on this subject. We thus will not disturb the conclusion with respect to trackage rights fees reached in the Opinion. That estimate was based upon the computations of EL's own witness as to the respective maintenance costs of the passenger and freight lines, which LV adopted, see note 2, *supra;* we disagreed only as to the proportion of the costs on the passenger lines properly attributable to freight service. To accept LV's present argument would suggest that the calculations EL commissioned Shannon to make—in determining both the quantity of maintenance costs that should be attributed to the New Jersey passenger lines and the allocation of that quantity between passenger and freight use—were completely unnecessary since EL's 1973 maintenance costs could have been adjusted directly by deducting the $4.3 million figure from the passenger avoidable cost study for the State of New Jersey. We see no unfairness in holding LV to what is effectively its own study at this stage of the case in the absence of any reasonable alternative.

D. *New Jersey Taxes*

In n.310 of the Opinion we indicated our agreement with the GPs that EL-LV expenses should be adjusted to include additional New Jersey property taxes for the LV of $403,000. This figure represented the difference between $175,000 which the GP asserted were included in the unit cost calculations for EL-LV

and LV's total New Jersey taxes of $588,000.[5] The GPs found the $588,000 number in Exhibit LVR-Adik-1 at SR 45 and also in LV's 1973 Form R-1, and suggested that the only appropriate modification was "any amount applicable to the small portion of LV's New Jersey property not included in EL-LV." Comments of Government Parties on Erie Lackawanna's Response to the Court's Letter of September 4, 1981, at 12, Sp. Ct. Rep. at N 37063. LV contends there are figures in the record showing directly the taxes on the LV properties that were conveyed, LVR-Adik-1, App. A. This lists seven segments and states that "Apportioned NJ Taxes" totalled $232,101. Consequently, LV urges the added New Jersey taxes should be only $232,101-$175,000, or $57,101.

The difficulty with LV's contention is the lack of any explanation how the $232,101 figure was arrived at. In the absence of this we see no reason to depart from the figure reported in LV's 1973 Form R-1. It was LV's burden to show how much of this related to unconveyed properties; it did not discharge this.

THE GPS' PETITION

The GPs' Petition relates solely to our computation of LPCs for LV and AA.

A. *LPCs for the LV*

(1) *Day One Dismissals*

The first point raised by the GPs' petition related to the Court's calculation of the number of LV employees that would have been dismissed on "Day One"—the first day following disposition. The GPs contend that the Court inappropriately treated LV witness Grotz's estimate of the number of LV *employees* dismissed on Day One as if it represented the number of LV *positions*

5. LV points out that on this theory the correct figure should have been $413,000 rather than $403,000.

eliminated on Day One. Thus, the GPs conclude that the downward adjustment that the Court applied to Grotz's estimate in Table 37 to arrive at the number of "employees dismissed" was improper, because Grotz had already calculated "employees dismissed".

At several points the Opinion did distinguish between "employees dismissed" and "positions eliminated". This distinction was intended as a shorthand reference to the Court's application of pre-day one attrition, post-disposition attrition, and rehire rates. "Employees dismissed" was equivalent to "positions eliminated" following application of these factors. We find no indication in Grotz's testimony that he attached a similar meaning to the phrases, although we recognize that the Opinion at 153 can be read to the contrary.

Most important, however, is the fact that Grotz's estimate of employees dismissed on Day One did not reflect adjustments for pre-day one attrition, post-disposition attrition, or rehiring. Rather, his estimate reflected only adjustments for unprotected employees and employees over age 64. Grotz (S) (Oct. 15, 1980) at Table 1. Thus, although the GPs might disagree with our decision to account for pre-day one attrition or with the timing of post-disposition rehiring, our methodology did not, as the GPs' petition suggests, result in any double-counting of these factors.

Grotz's estimate that 389 LV employees would be dismissed on Day One was based upon his calculation that on Day One LV would have had 2,487 protected employees and only 2,098 positions available for these workers, Grotz (S) (Oct. 15, 1980) at Tables 1 & 2. Grotz did not adjust his estimate of the number of protected LV employees on Day One to reflect pre-day one attrition, *id.* at 13, a decision we did not accept, Opinion at 156. Our adjustment for pre-day one attrition, which had the effect of reducing the number of protected LV employees on Day One, therefore involved no double-counting and was entirely appropriate.

Grotz did attempt to reflect post-disposition attrition and rehiring of dismissed employees, Grotz (S) (Oct. 15, 1980) at 23-25 & Table 7, and adjusted his estimate of "employees dismissed" to reflect these factors, *id.* Although in calculating the LPCs of both EL and LV we accepted Grotz's general methodology, in both instances we treated the timing of attrition and rehires differently from the Grotz study, *e.g.*, Opinion at 153. As Tables 1-6 (regarding EL) and 34-37 (regarding LV) of the Opinion indicate, we computed dismissal allowances and lump sum payments on the basis of the number of employees eligible for benefits *at the end* of the period under consideration. We recognize that we could have treated the question differently. Indeed, we said in the Opinion at 120 that "any one of numerous methods of calculating LPCs could be adopted." We do not think our considered choice of the timing of post-disposition attrition and rehiring was improper. Our treatment of attrition and rehiring took a consistently conservative view with respect to the usefulness of attrition, Opinion at 125-26, 153-54, 163. The fact that one aspect of our methodology could have been made even less favorable to the Ts is no basis for rejecting the conclusions reached in the Opinion. Implicit in our acceptance of Grotz's methodology was our recognition that LV could have used attrition and rehiring to reduce its LPCs, and we think our treatment of the issue was appropriate.

(2) *Alleged Inconsistency Between Tables 36 and 43 for Period Ending 10/81*

The GPs' second claim is that in calculating the LPCs attributable to the relocation of LV employees we inadvertently substituted the figure 39 in the final line of Table 43 when we intended to use the figure 79 which appears in Table 36. As our footnote to Table 43 indicates, the figures that appear in that table are drawn from Table 40 as well as Table 36. The figure 39, which reflects the number of employees that would have been rehired in the period beginning 10/81, is derived from the column headed "10/81" in Table 40. That column indicates that, although 79

positions were available for surplussed employees, see Table 36, there were only 39 LV employees still receiving dismissal payments, and thus only 39 employees could have been rehired. Accordingly, we reject the GPs' contention.

(3) *Displacement Allowance*

We find more merit to the GPs' claim that the court's estimate of the cost of displacement allowances for LV employees was understated because of our reliance on the FSP and Grotz's testimony that Penn Central paid only $76.28 to each displaced employee. Grotz (S) (Oct. 15, 1980) at 30. The GPs point out that, while Grotz cited the $76.28 per employee figure, he actually used a $533.28 figure in his calculations of LV's LPCs. They further note that no expert used the $76.28 figure, which reflected costs being incurred five and six years after the PC merger. LV responds that the Court properly relied on PC's historical experience, and directs us to Shannon's testimony that displacement allowances would have been minimal.

We accept the GPs' point, both because we intended to accept Grotz's study on the issue, and because we think the $533.28 figure is far more reasonable than the other estimates in the record, such as Kasher's base figure of $2,717.04 per year. Kasher (S) (Nov. 1, 1979) at 32. As calculated by the GPs, this increases LV's LPCs attributable to displacement allowances from $19,757 to $138,120.

(4) *Timing Considerations*

The GPs attack our discounting LPCs to January 1, 1974, as inconsistent with our conclusion (Opinion at 196, see also pp. 131, 154-61, 261-62) that the sale of EL-LV to a solvent railroad would have occurred on April 1, 1976. They propose that LPCs be discounted only to the latter date. The court attempted (Opinion at 66) to determine what *rate* of discount a purchaser making its decision on January 1, 1974, would have applied to a

cash flow it would not have begun to receive until April 1, 1976; we did not make any calculations of what this would mean in terms of purchase price. We used the same discount rate in connection with LPCs but there we applied the discount to reduce the costs to January 1, 1974, dollars. Consistency between these two items and with our conclusions with respect to timing would seem to be achieved best by discounting both the earnings stream and the LPCs to April 1, 1976, the conveyance date. However, LV suggests (Answer, p. 7 n.3), and we agree, that this point is too important to decide without further briefing. This can be had at the conclusion of the nonrail use phase of the case if the parties have not yet reached a settlement. We therefore leave this point undecided.

B. *Ann Arbor*

The GPs contend that our reference to a figure of $1,190,000 on p. 167 was incorrect. This was a typographical error, but one which had no effect on our result. We in fact used Kasher's undiscounted figure of $1,374,000, reduced this to $687,000 because of income taxes, and discounted this to $493,200.

The GPs also make the same point concerning discounting AA's LPCs to January 1, 1974, which they have advanced in respect of LV. We make the same disposition of it.

Appendix I

The petitions for reconsideration are granted in part, and denied in part, and decision is reserved in part, as indicated in this opinion.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: January 25, 1982

APPENDIX J

Appendix J

IN THE SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

FILED JUL. 12, 1983, JAMES F. DAVEY, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

Opinion on Valuation of the Central Railroad of New Jersey and the Lehigh & New England Railway for Nonrail Use

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

Frazer C. Hilder, Cary W. Dickieson, Stephen C. Rogers, Howard M. Wilchins, Judith L. Walter, and Christopher J. O'Donnell, United States Railway Association, Washington, D.C.

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Appendix J

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Appendix J

PER CURIAM:

I.

INTRODUCTION

This opinion, which can be referred to as the CNJ Opinion, begins where our opinion reported at 531 F. Supp. 1191 (1981) ends. Familiarity with that opinion and our other major opinions, notably the *Constitutional Minimum Value (CMV) Opinion,* 445 F. Supp 994 (1977), is assumed. While our 1981 opinion is generally characterized by the parties as the *Rail Use Opinion* and this proceeding as relating to nonrail use, and we shall follow this method of description, it is not entirely accurate. The earlier opinion did deal in the main with the valuation of railroads or segments of railroads which had established earning power and would be continued in rail use on that account. Also, for reasons detailed primarily in Part III of the opinion, 531 F. Supp. at 1210-14, it announced certain conclusions with respect to railroads that would be continued in rail use despite lack of earning power or with earning power but without the prospect of competitive bidding. We deferred the valuation of such railroads to the second phase of the proceeding and referred to "the values that we will determine in the second phase of the proceeding simply as X." 531 F. Supp. at 1213. We also made a number of observations both in the *CMV Opinion* and in the *Rail Use Opinion* which bear upon the determination of X. Broadly speaking, we concluded that for all categories of rail lines, X was the value that could be obtained by sale for the next most valuable use, namely, a break-up of the railroad and a sale of its component parts. We shall call this scrap value, although recognizing that for certain categories of property, e.g., rail, the sale might be for continued use by another carrier in supplying rail service.

When we initiated this phase of the proceeding by our Sixth Pretrial Order of June 12, 1981, it appeared that, despite the earlier settlement by the Penn Central, a number of carriers

would be involved. However, as described in the *Rail Use Opinion,* 531 F. Supp. at 1204, we received, on August 5, 1981, an application from the GPs and the Reading Company for approval of a settlement of the claims of the Reading and five other companies for which it was (or expected soon to be) in a position to speak. Settlements were later approved with respect to all of the railroads that had been involved in these proceedings with the exception of the Central Railroad of New Jersey (now, as a result of reorganization, Central Jersey Industries, Inc.) (CNJ), including its interest in the assets of the Raritan River Railroad[1] and the Lehigh & New England Railway (L&NE).[2] We found that despite CNJ's lack of earning power, "in the absence of the Rail Act, New Jersey would have bought all of CNJ's conveyed properties", 531 F. Supp. at 1379. L&NE conceded that the Tamaqua branch would not have been sold for continued rail use, 531 F. Supp. at 1374. With respect to L&NE's Bethlehem branch, we found that while the Chessie, as an acquirer of the Reading's class (a) lines and of the Lehigh Valley, might have bid for this, there would have been no competitive bidding and that "the sales price would not have been significantly more than the applicable version of X", *Id.*[3]

Even with the scope of the proceeding thus reduced, a formidable record has been compiled. The statements of witnesses and appendices for the CNJ and L&NE comprise 5154 pages; those for the GPs 3368; and 17,435 pages of depositions were taken. The GPs' opening and reply briefs contain 786 pages; the CNJ's and L&NE's 741. Oral argument was heard on March 16 and 17, 1983.

The CNJ presented two theories of its case. Its preferred version was what it terms the "perception theory"—perhaps better described as the "constructive offer" theory. Under this theory CNJ endeavors to reconstruct what would have happened in the real world if the Rail Act had not been passed and its validity sustained, first by us in the *180 Day Appeals,* 384 F. Supp. 895

(1974) and later by the Supreme Court, *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974), the former disagreeing with and the latter reversing *Connecticut Gen. Ins. Corp.* v. *United States Ry. Ass'n*, 383 F. Supp. 510 (E.D. Pa. 1974). Alternatively it submitted its own scrap value model, avowedly following the same principles as that of the GPs but unsurprisingly producing quite different results. The results of the models (in thousands) were:

CNJ perception theory	$72,886
CNJ perception theory as adjusted by GPs	$33,169
CNJ scrap value model	$82,441
GPs scrap value model	$22,932

We shall first analyze, and ultimately reject, CNJ's perception theory and then take up, category by category, the two scrap value models. While we shall not be able to arrive at an exact figure, we aim to express the governing considerations in sufficient detail that the parties should readily be able to agree on one, or, failing agreement, to submit figures carrying out our decision, with supporting memoranda.

II.

CNJ's Perception Theory

The takeoff point for CNJ's perception theory is the negotiations between Alan Sagner, Commissioner of Transportation for New Jersey's newly elected Governor, Brendan Byrne, and CNJ's Trustee and representatives of its security holders, in the spring and early summer of 1974, which are reviewed in the *Rail Use Opinion*, 531 F. Supp. at 1375-77. CNJ claimed that at a meeting with CNJ bondholder representatives on July 18, 1974, Sagner committed New Jersey to purchasing virtually all of CNJ's properties at a price equivalent to about $100 million for the conveyed properties, and that just compensation required CNJ to

be paid that amount.[4] CNJ's legal theory was apparently premised on the argument that "the Transferors' entitlement was to be measured by the indemnity required to compensate for the value of their lost opportunities", CNJ Opening Brief With Respect to Sales for Rail Use at 4, and that the frustration of the sale to which New Jersey had allegedly agreed was such a lost opportunity. We had no occasion to explore the legal validity of CNJ's theory since we concluded that the evidence did not support its contention "that an agreement had nearly been reached", 531 F. Supp. at 1378. One of the reasons sustaining our factual conclusion that no definite offer was in the immediate offing was Sagner's statement to a representative of the bondholders on July 30 that he had commissioned a further study by L.E. Peabody & Associates and that any proposals he would make would be based on that study, 531 F. Supp. at 1376.

With its argument based on a July 1974 "near agreement" thus having been rejected on the facts, CNJ here makes a similar argument on the basis that the evidence shows an agreement would have been reached in the fall of 1974. It contends that four studies in the State's possession, two of which—the Peabody study and the Hyde study—were commissioned by the State as a result of the discussions in July 1974, established a frame of reference that would have resulted, after further negotiations, in a purchase price in the neighborhood of $72,886,000 for the conveyed properties. This is put forward as a form of the "foreclosed option" principle, *see* 445 F. Supp. at 1012-13, which the GPs have recognized in other contexts. The argument is that but for the Rail Act and the court decisions sustaining it and holding it applicable to CNJ, Commissioner Sagner would have returned to the negotiating table and would have made an offer derived from the four studies, especially the two recent ones he had commissioned. Deprivation of the opportunity to accept such an offer would constitute on this view a taking of property compensable under the Fifth Amendment.

To analyze the argument a bit further, its premise is that if the State of New Jersey had made a firm offer to purchase the conveyed properties and this was rendered ineffectual by enactment of the Rail Act and the decisions upholding its validity and applicability to CNJ, foreclosure of CNJ's right to accept this offer would be a taking requiring payment of just compensation. The argument then proceeds from this premise to a conclusion that the same consequences should follow if the evidence shows with sufficient certainty that a firm offer of a fixed amount (or falling within an acceptably small range) would have been made but for the intervention of the Rail Act.

As indicated above, we previously found it unnecessary, *see* 531 F. Supp. at 1378, to consider the legal validity of the premise, namely, that frustration of a firm offer would be compensable, since we concluded that the necessary facts had not been established. The weight of authority is that offers to purchase property under condemnation are not even admissible,[5] much less determinative. However, the reasons expressed for this are singularly inapplicable to the kind of offer posited by CNJ. One is the danger of fabrication; however sound this may be with respect to oral offers, it would have scant applicability to a formal offer bearing the signature of the Governor or other authorized officer of New Jersey. Another argument, that the offer may have been made irresponsibly, without any real intention of consummation, is equally inapplicable to an offer of the sort described. A further objection, lack of knowledge by the offeror, is similarly inapplicable where a state which has been formally studying the question for months makes a firm offer. A final objection, made with respect to persons having the power to condemn, is that the offer may include a premium to avoid the expense of condemnation and the risk of an excessive award. This objection is removed when the court can determine, from the appraisals on which the offeror relied or from other circumstances, that no such element existed. Although it is unnecessary to decide the point, we thus do not readily dismiss the premise of CNJ's perception theory.

Movement from the case of an actual offer to one where none has been made is a quite different matter. The first issue is one of law. Has a condemnee been deprived of anything for which he is entitled to compensation because of having lost the opportunity to accept an offer which was not but rationally could have been made on the facts available at the time? We find it unnecessary to decide this beyond noting that an affirmative answer would open up possibilities for condemnees that are not to be contemplated lightly. Such considerations suggest that, even if we were to assume *arguendo* that the question should be answered in the affirmative, the proof that the offer would probably have been made and what it would have been must be clear and convincing. CNJ's perception theory shatters on this rock.

CNJ's evidence with respect to the probability and amount of the State's offer begins with Sagner's requests on July 26, 1974, for two independent valuations of CNJ which are referred to in the *Rail Use Opinion,* 531 F. Supp. at 1376, and which we shall now discuss in more detail. The first was by the firm of L.E. Peabody & Associates, which had long advised New Jersey on real estate matters. On July 26, 1974, Lee Peabody and William Whitehurst of that firm met with Commissioner Sagner. Lee Peabody later prepared a memorandum of the meeting. This recited that the Peabody firm was to determine the value of the CNJ on the bases of "book value, reproduction value, net liquidation value, and going concern value" and that in doing so it was to "use the Wyer Dick and DeLeuw Cather reports" described below. The Peabody report was submitted on September 23, 1974. While it reported values on the three other bases specified,[6] it concluded that the value most useful for negotiations with CNJ was net liquidation value. This it found to be $113 million as of December 31, 1973, which "should be discounted 20 percent to reflect the elimination of future uncertainties and risks resulting in a value of $90 million." In arriving at this figure the Peabody firm relied heavily on a study of the net liquidation value (NLV) of all of CNJ's assets as of June 30, 1968, made pursuant

to Orders 101 and 137 of the CNJ reorganization court by Wyer, Dick & Co. and completed June 12, 1970. This had relied for real estate values on a report made by the firm of Van Horn & Dolan, which had assisted CNJ in regard to real estate matters for many years.

The second study was by James V. Hyde, Jr., Director of the Right-of-Way Division of the New Jersey Department of Transportation. As reflected in a memorandum dated July 24, 1974, the Division was asked to submit within 60 days reports on the value of the CNJ (excluding rolling stock) as an operating railroad in use and at liquidation or net salvage value. The report, consisting of three volumes, estimated the liquidation value of the CNJ's land and trackage at $121,005,000, as of October 1974.

The Wyer Dick study had shown a NLV of $79,654,000 as of June 30, 1968. Shortly after its preparation, New Jersey retained DeLeuw, Cather & Co., which was later to make many studies for the GPs in connection with these proceedings to review the Wyer Dick study and "to express opinions on the methods and procedures used . . . and on the accuracy of the values presented therein." DeLeuw Cather Study, 1 CNJ App. at 80. DeLeuw Cather, with the approval of the State, retained the New Jersey real estate firm of Stack & Stack to review the estimated values of land contained in the Wyer Dick study. Agreeing with some of Wyer Dick's conclusions, and believing others to be too favorable but more to be too unfavorable to CNJ, it concluded that the net liquidation value of the CNJ as of June 30, 1968, was approximately 15% greater than Wyer Dick's estimates, or, in other words, $91 million. Particularly DeLeuw Cather regarded Wyer Dick's real estate values as too low.

At the trial CNJ undertook to distill from the four studies what New Jersey would have thought the NLV of the conveyed properties would be. It did this through two witnesses, John Van Horn, a real estate expert of long experience who, as stated, had been involved in the Wyer Dick study, with respect to real estate, and Jack Storm, who was Director of Engineering for Snavely, King

& Associates, Transportation and Economic Consultants, with respect to other assets. The problems faced by these witnesses were formidable. All the appraisals had dealt with the totality of CNJ's assets. Some of these assets had been disposed of before enactment of the Rail Act and not all of the remainder were designated for conveyance. Other categories had increased in quantity between December 31, 1973 and the conveyance date, April 1, 1976. The methodologies of the studies differed with respect to many important matters. Some discounted the assumed proceeds of sale to present value; others did not. The Peabody study simply trended Wyer Dick's real estate values upward; Hyde made an independent appraisal. The Hyde study made a deduction for title defects; the Peabody study did not. Despite all these problems, Storm felt able to conclude that New Jersey would have perceived the NLV of the conveyed properties in 1974 to be $69,472,000 on the basis of the Peabody study and $72,886,000 on the basis of the Hyde study. As indicated, CNJ urges the $72,886,000 figure, primarily on the basis that Hyde made an independent appraisal of the real estate, whereas Peabody had simply trended Wyer Dick's real estate values which DeLeuw Cather had considered too low.[7] The GPs, while challenging the whole concept of the perception case on both legal and factual grounds, retort that if proper adjustments were made, New Jersey's 1974 perception would have been only $33,169,000.

The GPs mount their factual attack on a broad front. They emphasize that neither Storm nor Van Horn purported to testify what New Jersey in fact perceived; their testimony was limited rather to how Peabody and Hyde would have perceived the value of the assets conveyed on April 1, 1976, and, inferentially, how the State should have perceived this on the basis of their appraisals. They emphasize CNJ's failure to call any New Jersey officials as witnesses. The GPs called Whitehurst to testify that the Peabody study was designed simply to meet Commissioner Sagner's request for a "rough cut" and to supply a "rank order" of alternatives. CNJ answers that nothing in the letter transmitting

the Peabody report suggests that it was a "rough cut" and that the authors of the study knew that negotiations would proceed on the basis of NLV and the other figures were included for cosmetic purposes, such as showing that a purchase at net liquidation value would be a good deal for the State. Whitehurst also pointed out a number of serious defects in his firm's study, such as the lack of an independent real estate appraisal, failure to consider the timing of the liquidation process, failure to discount proceeds to be received over a term of years to present value, and failure to take account of potential glut. CNJ responds that this poor mouthing of the report ill comports with what the Peabody firm said at the time and also that if there are defects, these can be rectified by resort to the other studies, particularly the Hyde Study. Whitehurst concluded that he "would not have advised the State of New Jersey to proceed to set a purchase price on the basis of [the] figure" set forth in his firm's report. Whitehurst Testimony, June 2, 1982, at 7. CNJ answers that this is exactly what the report purported to do, indeed, that what Commissioner Sagner wanted was a floor since he expected CNJ's zealous Trustee, R.D. Timpany, to press for more.[8] CNJ calls attention to a memorandum prepared by New Jersey state officials of a meeting with federal officials in Washington on August 23, 1974, in which Sagner stated that he expected the Peabody report to place a net liquidation value of $70 to $80 million on CNJ's rail properties. The GPs did not call Hyde but relied on an affidavit in which he said that his study was "a preliminary planning study related solely to the transportation activities of the Department of Transportation", which it manifestly was not, and that it "had nothing to do with the acquisition of land through condemnation." CNJ objects to this affidavit as inadmissible hearsay, as it well may be. In any event, while the statement that the report "had nothing to do with the acquisition of land *through condemnation*" (emphasis supplied) is literally correct, the letter transmitting the report clearly stated that it was an estimate of the liquidation value and also that "the equitable

true market value of the present system lies between the Liquidation Value and the Value-in-Use." More impressive are the GPs' attacks on the Hyde Study, pointing out the use of all sales in the area rather than sales of comparable properties to value real estate, the admitted failure to allow for title defects, and the wide disparity between Hyde's estimate of the values of two parcels retained by CNJ under the Final System Plan and what was actually paid for them by the State.

We are left with two conflicting impressions. One is that, on the basis of the appraisals, Sagner would have returned to the bargaining table with an offer which exceeded not only the GPs' presently asserted scrap value figure but the higher scrap value figure we have found. For one reason or another the minds of all concerned in 1974 were attuned to a higher scale. There is, for example, no evidence that in 1974 New Jersey entertained such ideas as that all of CNJ's ties and much of its rail was valueless, largely because of glut, although perhaps it ought to have done so. The other impression is that we have no sufficient basis for finding what New Jersey's offer would have been. For one reason, neither the Peabody report nor the Hyde report gave any satisfactory notion of the liquidation value of CNJ's real estate,[9] as CNJ's expert Van Horn conceded. We cannot assume that the State would have entered into serious negotiations when one of its figures with respect to such a major item was more than 150% of the other. Perhaps there might have been a split-the-difference approach, perhaps New Jersey would have commissioned a new appraisal of the real estate, perhaps something else would have occurred—we simply do not know. While it "has been obvious . . . from the beginning . . . that no amount of effort by counsel and the court will produce a mathematically precise figure of what the estates are constitutionally entitled to receive and the Government is required to pay" and that "the best for which anyone can hope is a fair approximation", *Compensable Unconstitutional Erosion (CUE) Opinion,* 439 F. Supp. 1351, 1390 (1977), we cannot properly award judgment on the basis of mere

speculation. CNJ has simply not met its burden of showing by clear and convincing evidence that, after the Peabody and Hyde appraisals were available, New Jersey would have made an offer at any ascertainable figure, and we therefore need not discuss what the result should be if CNJ had carried its burden on the facts.

III.

REAL ESTATE

A. *Base Value*$_{10}$

The parties stipulated to real estate base values in all counties except three. With regard to the real estate in Essex, Hudson, and Union Counties, the parties arrived at widely divergent base values. CNJ conveyed approximately 940 acres in those three counties to Conrail. CNJ assigns a base value of $33.4 million to the conveyed real estate in the three counties, while the GPs have adopted a $17.6 million figure.

CNJ and the GPs have used a market data approach to arrive at their estimates. Under this approach, an appraiser attempts to determine the value of the property at issue by inspecting or otherwise determining the characteristics of the parcel of property. The appraiser then examines sales of similar property to come up with the "going rate" for property in the area. CNJ refers to the resulting figure as the "typical property value"; the GPs refer to the result as the "across the fence value". Although some underlying assumptions differ, the two terms describe the same basic appraisal methodology.[11] *See* Hannoch/Heaney Deposition, January 11, 1982, at 30-31, 2 CNJ App. at 136-37. By adjusting the comparable sales figures to take into account the peculiar characteristics of the subject property and any change in price levels or other circumstances warranting adjustment between the date of the comparable sale and the valuation date, the appraiser hopes to arrive at an accurate estimate of the property's value.

Appendix J

As the use of the term "comparable sales" indicates, the market data approach necessarily involves many subjective judgments on the part of the appraisers. The parties spend many pages in their briefs singing the praises of their own appraisers and attacking the credentials and objectivity of the appraisers who worked for the other side. Because we find fundamental flaws in the assumptions underlying the estimates of both CNJ and the GPs, we do not fully accept either party's estimate of real estate base value.

1. *CNJ Appraisal*

In conducting their studies, the CNJ appraisers, Franklin Hannoch, Jr., and Michael J. Heaney, employed two assumptions that detract significantly from the reliability of their estimates. The first invalid assumption involves the availability of continued rail service to CNJ's conveyed parcels. The parties do not dispute that if a piece of industrial real estate has access to a rail line it is worth more to a potential buyer than one not having such access. The parties did not agree, however, on whether particular parcels would continue to be served by a rail line after the conveyance of the property to Conrail. CNJ's appraisers assumed that all CNJ real estate would continue to be served by a rail line if the purchaser so desired. CNJ contends that this assumption is necessary to vitiate the unfairness that would result if the government forced CNJ to convey property for the formation of a railroad and then valued the property as if the railroad did not exist. Hannoch/Heaney Deposition, March 24, 1982, at 782, 33 GPs Supp. App. at 228.

CNJ's argument overlooks the fact that, in the conceded absence of proof that the property in question had earning power that would make it valuable for rail use, it is entitled to compensation based on the property's nonrail use value. *See* Sixth Pretrial Order, Sp. Ct. Rptr. N-35965, at ¶ 1. By assuming continued rail service to all conveyed parcels, CNJ would have us value its property as if the CNJ would continue as a functioning unit,

whereas the assumption underlying the nonrail use approach is precisely the contrary.

Our holding does not suggest, however, that none of the CNJ property would ever be served by a rail line. Many parcels are close enough to other northeastern rail lines for the construction of a spur to service the property that would be both economically feasible and desirable. *See* Peabody Study, Analysis of CNJ Freight Traffic by Line Segment, September 19, 1974, at 77-107, 1 CNJ App. at 307-37;[12] *cf. New Haven Inclusion Cases,* 399 U.S. 392, 453-57 (1970).

Unfortunately, we are unable to adjust the CNJ figures to reflect continued rail service to some, but not all, parcels. The CNJ appraisers did not consider the rail service potential of individual parcels. They uniformly assumed that each parcel would have continued rail service. Hannoch/Heaney Deposition, March 24, 1982, at 782, 33 GPs Supp. App. at 228. Furthermore, Hannoch and Heaney admitted that the continued rail service assumption had played an important part in their valuations, but they were unable to estimate how much their real estate estimates would decrease in the absence of the continued rail service assumption. *See* Hannoch/Heaney Deposition, March 24, 1982, at 741-48, 2 CNJ App. at 311-16.

The other faulty assumption on which Hannoch and Heaney relied relates to topography. A substantial portion of the property in question is old CNJ rights of way. Much of this property contains embankments or depressions constructed to maintain even track levels. The embankments mainly consist of ballast and fill materials. The parties assumed for appraisal purposes that the rights of way would have been stripped of rail, ties, and ballast before sale. The CNJ appraisers went one step further and assumed that, with respect to embankments, the land would be returned to its original contours prior to sale.[13] This assumption was based on the premise that fill materials could be sold on site for a price greater than the cost of removal.[14]

Even if we were willing to assume that fill could be sold, we are unwilling to conclude that the presence of embankments should be ignored in estimating the value of the parcels on which the embankments stand. If a market existed for fill, CNJ still should have considered the side effects of removal. For instance, the CNJ appraisers should have taken into account the difficulty of removing fill from remote, narrow rights of way and the ecological impact of heavy earth-moving machinery on adjacent land.

Removal of all embankments also would be an extremely time-consuming endeavor. Fill could be sold only as a need for it arose in the marketplace. Because removal of all embankments would involve disposal of more than 6.4 million cubic yards of fill, we assume that the market would not absorb the supply of fill within a short period of time.[15] As a result, sale of those parcels containing embankments would be delayed pending the sale of the fill. This delay would translate into lower present values for the proceeds from the sale of those parcels.

Furthermore, removal of fill might hinder the sale of parcels not containing embankments. A buyer might be hesitant to purchase a segment of right of way if he anticipated use of his property by CNJ as a means of access to a parcel from which fill was to be removed. Taken as a whole, these factors indicate that the CNJ's appraisers incorrectly ignored the effect that embankments would have on base values of real estate.[16]

CNJ's misconceptions with regard to topography and continued rail service signify that its methodology in arriving at real estate values is fundamentally flawed. Hannoch and Heaney admitted that their assumption of continued rail service was an integral factor in their valuation. Hannoch/Heaney Deposition, March 24, 1982, at 772-73, 38 GPs Supp. App. at 200-01. We have stated that we are unable to adjust their figures to take into account any rail service that would have been available. CNJ's erroneous assumption that all real estate with embankments would be restored to its original contours has an equally unquantifiable effect on the CNJ estimates.[17] In short, Hannoch and

Heaney have cast substantial doubt on the accuracy of their appraisals by basing their work, in part, on two incorrect assumptions.

2. *GPs Appraisal*

Unfortunately, the GPs' valuations suffer from some severe inadequacies as well. One such inadequacy involves continued rail service. As we pointed out in our discussion of CNJ's continued rail service assumption, some parcels might have had continued rail service from other nearby rail lines. *See* Peabody Study, Analysis of CNJ Freight Traffic by Line Segment, September 19, 1974, at 77-107, 1 CNJ App. at 307-37.[18] Nevertheless, the GPs instructed their appraisers to assume that none of the parcels would be serviced by rail. GPs Opening Brief at D-9. Just as the CNJ appraisers were too liberal in assuming rail service to all parcels, the GPs were too conservative in assuming no rail service. The proper approach would have been to determine the accessibility of each parcel from rail lines that would have been proffered for continued service after April 1, 1976, and would have met the tests laid down in our *Rail Use Opinion.*

Another shortcoming of the GPs' studies involves the GPs' choice of comparable sales figures. The GPs instructed their appraisers to consider only sales occurring before April 1, 1976 in arriving at their "across the fence" values. In many cases, sales of property similar to that which was being appraised occurred after April 1. In some cases, Conrail sold the very parcels under examination.[19] The CNJ appraisers testified that they considered all comparable sales in arriving at their figures. *See* Hannoch/Heaney Deposition, January 11, 1982, at 31-32, 2 CNJ App. at 137-38.

The GPs argue that post-April 1 sales should not be considered because they may distort the value assigned to a parcel of real estate. The GPs contend that a purchaser who buys property after the valuation date has at his disposal information not available on or before the valuation date. The price paid for similar

property after the valuation date, therefore, does not accurately reflect the economic environment on that date.[20]

We find the GPs' reasoning unpersuasive. Although a post-April 1 buyer might have more information at his disposal than a hypothetical buyer as of the valuation date, a buyer of comparable property before April 1 would have less information than the hypothetical buyer. Therefore, we see no reason to assume that pre-valuation date sales have any more merit for establishing the market value of the subject property than post-valuation date sales, unless the latter have been influenced by the condemnation of the subject property. We find that the GPs' appraisers should have considered post-April 1 comparable sales in determining the NLV of CNJ's conveyed real estate.

Just as we find it impossible to rectify the effect of CNJ's erroneous assumptions on its estimate of base value, we cannot quantify the effect that the GPs' misguided instructions had on their real estate valuations. Referring to the issue of continued rail service, counsel for the GPs stated at oral argument, "unquestionably, it has a very significant impact". Transcript at 153. The GPs' opening brief states that the assumption of continued rail service is "a major reason why the base values presented by Messrs. Hannoch and Heaney are so much higher than those of the Government Parties". GPs Opening Brief at D-51.

In a similar vein, the GPs did not indicate how much real estate values would have changed had they considered post-April 1, 1976 sales data. The evidence indicates, however, that the CNJ appraisers relied heavily on post-April 1 sales and that the GPs appraisers had available to them many post-April 1 comparable sales with which they could have worked.[21] The net effect of these two errors in the GPs' appraisal methodology is to undermine the credibility of the GPs' real estate values. We therefore cannot adopt the GPs' estimate of $17.6 million as the base value of conveyed real estate in the disputed counties.

3. *Van Horn Appraisal*

Although we find fundamental flaws in the real estate estimates propounded by both sides, we believe that there is an equitable means of arriving at more accurate real estate base values. The evidence indicates that Hannoch and Heaney relied to a great extent on information provided by the appraisal firm of Van Horn & Dolan. From the 1950's until 1978 the Van Horn firm, principally under the supervision of John Van Horn, performed a number of appraisals for CNJ. In 1969-70, Van Horn appraised several individual parcels of CNJ real estate and served as project manager for a complete appraisal of all CNJ's real estate valued as of June 30, 1968. In 1974 and 1975, he supervised another complete appraisal of all CNJ real estate.

Van Horn's association with CNJ did not end with the conveyance of most of CNJ's property to Conrail. Since April 1, 1976, Van Horn (and his firm) has acted as consultant and manager of CNJ's retained real estate, and has performed some services with regard to conveyed real estate. These services have included the preparation of a land inventory and maps of CNJ's conveyed property in late 1977 and early 1978.

Between August 1978 and the end of the year, in response to a request from CNJ's counsel, Van Horn updated his previous work to arrive at a nonrail use value for CNJ's conveyed property as of April 1, 1976. CNJ did not use Van Horn's appraisal as evidence of real estate base values. Instead, it commissioned Hannoch and Heaney in July 1981 to perform new appraisals. Van Horn furnished Hannoch and Heaney with work papers containing sales and other component data and maps accumulated by his firm.[22] CNJ has not given any explanation for its decision to change appraisers.

Three aspects of the 1978 Van Horn appraisal recommend it to us, other than Van Horn's long-standing familiarity with CNJ property. First, Van Horn made no artificial assumptions, such as the blanket presence or absence of continued rail service,

regarding access to the conveyed property.[23] Van Horn did not assume that the real estate would be returned to its original contours.[24] Finally, Van Horn considered some post-April 1, 1976 sales in arriving at his estimates.[25]

CNJ has long maintained that the Van Horn estimates are unreliable indications of the base value of its conveyed real estate.[26] In its attemp to deny the GPs access to most of Van Horn's study, CNJ referred to Van Horn's study as a "false start" appraisal. CNJ argued that the Van Horn appraisal was hastily performed as a means of arriving at preliminary estimates of real estate values rather then final figures. CNJ contended that Van Horn designed his 1978 update of previous appraisals only to give CNJ's counsel a general indication of the value of conveyed real estate. *See* Objections of Central Jersey Industries, Inc., and Brief in Support Thereof, to Government Parties [sic] Motion of January 19, 1982, to Compel Production of Certain Documents, January 25, 1982, at 5. Although CNJ's brief does not set forth its objections to the use of Van Horn's figures, we assume that CNJ still harbors the concerns stated in its January 25, 1982, memorandum.

CNJ's argument not only ignores the fact that Van Horn's past experience with CNJ's property qualified him to perform such an appraisal, but also that Hannoch's and Heaney's work relied heavily on Van Horn's data. Moreover, Van Horn spent five months updating figures he had compiled over a period of several years. By comparison, Hannoch and Heaney conducted their entire appraisal in about four months.

Another factor that recommends the Van Horn figures as accurate reflections of the base values of the CNJ real estate is that the GPs have recognized the Van Horn study as having been based on more acceptable assumptions than the Hannoch and Heaney study. During oral argument, the GPs stated that one way to quantify the effect that the CNJ's continued rail service and topographical assumptions had on the Hannoch and Heaney figures is to compare them with those of Van Horn because the

Van Horn study did not make the same misguided assumptions. Transcript at 255. Furthermore, the GPs imply in their brief that they felt that Van Horn was much more qualified to appraise the CNJ property than Hannoch and Heaney. *See* GPs Opening Brief at D-41 to 45.

We find that Van Horn's 1978 estimate of the base value of CNJ's real estate in the three disputed counties is the most accurate indication of that property's value. Van Horn was familiar with the property and had appraised the property on several occasions in the past. If he made mistakes with regard to the physical attributes of that property, those mistakes probably infected Hannoch and Heaney's appraisal as well, because of their reliance on the Van Horn work papers. The assumptions used by Van Horn in conducting his study were superior to those used by both the CNJ and GPs appraisers. Finally, the GPs have implicitly recognized that the Van Horn figures have, at least, some validity. We find the base values in the disputed counties to be:

Essex	$ 3,279,800
Hudson	2,653,700
Union	
Elizabethport	10,162,700
Other	8,369,000
Total	$ 24,465,200

B. *Adjustments to Base Value*

1. *Title Defects*

The GPs contend that the base value of CNJ's conveyed real estate must be reduced to eliminate the base values of conveyed parcels for which CNJ would not have had marketable title in a nonrail use liquidation of the real estate.[27] The GPs would also deduct the cost, including the cost associated with the delay in receiving proceeds from sales, of bringing quiet title actions for

parcels, title to which would be defective but curable. To estimate these adjustments for title defects, the GPs introduced testimony of Paul E. Lacouture, an attorney of considerable experience in real estate titles. He reviewed 102 valuation maps of CNJ conveyed property, representing over 90% of the base value appraised by the GPs, as well as title deeds and other documents in the possession of Conrail.

Lacouture found that CNJ, in assembling its original rights of way more than a century ago, acquired many easements, licenses, and determinable and conditional fees subject to reversion upon cessation of rail use. For all such rights of way, Lacouture concluded that CNJ would have had no title to transfer in a nonrail use liquidation and, thus, this property should be assigned no value.[28] Also CNJ had terminable or limited interests in land in some cases raising title problems which could be cured by quiet title actions. John H. McDermitt, an attorney with thirty years' experience in New Jersey title litigation, testified that quiet title actions for curable defects could be successfully completed in an average of twenty-three months at an average cost of $5,258. Combining the elimination of sale proceeds where title defects were insurmountable and the cost of cure and delay in receipt of proceeds for lesser defects, Lacouture concluded that CNJ's real estate base value should be reduced by 7.187%.

CNJ's principal argument in opposition to a deduction for title defects is that unless reversion of title to any such parcel was imminent as of the valuation date, CNJ as the holder of a defeasible interest in the parcels was entitled to compensation for their full value. The great majority of the title defects uncovered by Lacouture were reversionary interests taking effect on cessation of rail use. CNJ argues that cessation of rail use on the conveyed properties in the absence of the Rail Act was never contemplated and thus that injustice would result if we were to carry our assumption of a nonrail use liquidation to its logical conclusion of divesting CNJ of title to real estate that would in fact never have gone out of rail use. The authorities cited by CNJ support the

proposition that where, as a consequence of a condemnation proceeding, a defeasible interest that would otherwise have subsisted indefinitely is extinguished, the holder of the defeasible interest is entitled to compensation as if possessed of an estate in fee simple absolute, *Terminal Coal Co.* v. *United States,* 172 F.2d 113, 116 n.5 (3d Cir. 1949); *United States* v. *635.76 Acres of Land,* 319 F. Supp. 763, 767 (W.D. Ark. 1970), *aff'd.,* 447 F. 2d 1405 (8th Cir. 1971) (per curiam); Restatement of the Law of Property § 53, comment b (1936). The authorities, however, are not apposite since the condition of indefinite subsistence apart from the condemnation is not met. The only prospect of continued rail use of CNJ's lines lay in condemnation by or sale in lieu of condemnation to the federal government or New Jersey. Thus reversion of title was neither remote nor speculative: it was imminent unless there was intervention by some authority with eminent domain power and willingness to carry on a losing operation. Where, but for the action of a condemnor, the condemnee's determinable or conditional title to real estate would most likely be lost in the near future, no compensation is required. We therefore eliminate the base values of those portions of CNJ's real estate which would have reverted upon cessation of rail use.[29]

CNJ further argues that the GPs' deductions, if permissible, are greatly overstated. Its appraisers testified that less than 3% of the conveyed acreage was subject to title defects, but gave no estimate of the value of this real estate. CNJ also introduced a letter from a New Jersey title insurer who reviewed 10 "representative" title deeds and opined that those merely imposing "restrictions" that parcels be used for railroad purposes and those reserving to grantors a right of reentry might under certain conditions be insurable.[30] While we recognize that the successors in interest of the original grantors may well have disappeared in the intervening century, this does not justify an award to CNJ on the basis of marketable title where it has no title or would have to incur the costs and delay incident to a quiet title action prior to any sale—even though the result is that the GPs will be paying no

compensation for certain property that Conrail is using. CNJ did point out, and the GPs conceded, an error of $6,240 in Lacouture's deduction from the GPs' base values. To reflect this correction we will make an adjusted deduction of 7.162% from base value for title defects.[31]

2. *Selling Costs*

Apart from its general objections to the deduction of selling costs, which we reject in Section VI.B. under the heading "Liquidation Organization and Disposition Costs", CNJ argues that in the ordinary condemnation proceeding employing the "comparable sales" approach with respect to real estate, no deduction for the costs of selling a parcel of real estate would be made. *See, e.g., State* v. *Brooks,* 152 So.2d 637, 641 (La. App. 1963). However, the GPs insist that where, as here, the sale is of a large tract which must be broken into parcels, the costs of sale must be deducted. We need not encumber this opinion with citation of the GPs' many authorities, since the Supreme Court's opinion in *New Haven Inclusion Cases, supra,* 399 U.S. at 436-37, is ample precedent for the deduction of holding and selling costs when railroad property is to be divided and sold over a long period of time.

The GPs estimate the deduction at $3,002,000 as against a base value of $25,166,500. CNJ's figure is only $190,000 as against a base value of $40,093,770. The enormous difference comes from two factors: CNJ contends that the organization it was obliged to retain to sell its non-conveyed properties could have done much of the work incident to the sale of the conveyed properties at no additional expense. It contends also that its own experience in selling its retained real estate indicates that the GPs' estimated selling costs are much too high. We deal with these contentions under the following categories:

(a) Cost of Sales Force.

(b) In-House Disposition Costs.

(c) Surveys, Transfer Taxes, and Attorneys' Fees.

Appendix J

(a) *Cost of Sales Force.* The GPs introduced testimony of Arnold S. Tesh, USRA's Director of Real Estate. Tesh concluded that the most effective method of disposition of CNJ's developable properties would be to supplement CNJ's in-house sales force with a central marketing agent who would develop overall plans and contact and supervise real estate brokers. Tesh thought that the fees of the central marketing agent, including brokers' commissions, together with the expense of the in-house staff would amount to 10% of the gross sale proceeds. Testimony of Eastdil Realty Inc. supported Tesh's 10% estimate for developable properties. This figure is in line with estimates of selling costs in the 1968 Wyer Dick study (up to 10%),[32] the 1974 Peabody study (12½%, including other closing costs), and the 1974 Hyde study (10%). Tesh further testified that sale of abutter properties would have been more difficult, requiring 15% of gross proceeds to compensate independent local brokers and a limited in-house sales force. Sales expenses set any lower than this, Tesh believed, would lead to a slower pace of sale and, with the effect of discounting, would result in a lower figure for net proceeds.

We are not persuaded that a figure higher than 10% is warranted for the sale of abutter properties. Perhaps, as the GPs contend, a broker must be more persistent in his efforts to persuade an abutting owner to buy and would demand higher commissions since the amount of each sale is relatively small. At the same time the broker expends no effort or advertising expense in locating his prospective buyer, and this would work the other way. Furthermore, as Tesh conceded, a larger proportion of sales of abutter properties would be made by CNJ's in-house staff. We conclude that no sales force expense greater than 10% should be deducted for any of CNJ's conveyed real estate.

CNJ would have us further reduce the rate of selling expenses in the light of its own experience in selling well over half of its 2000 acres of retained real estate. From April 1, 1976, to the end of 1981, according to testimony of John Van Horn, CNJ received

nearly $21 million in proceeds of real estate dispositions of retained properties while incurring no in-house expenses and only $455,000 (or 2.17% of gross proceeds) in fees and commissions paid to the firm of Van Horn & Dolan. However, more than $17 million of these proceeds derived from two condemnations by the State of New Jersey (one still in litigation) and a sale to the Port Authority of New York and New Jersey, transactions which the GPs argue are "not representative". In sales to private purchasers, Van Horn's commissions ranged from 6% to 10%, a range that Van Horn testified to be "typical" in sales of vacant land in New Jersey. Lower commissions were incurred with respect to the more expensive properties. While CNJ's experience in disposing of its retained real estate is impressive, this is another instance where CNJ has failed to provide us with an alternative figure to substitute for that supplied by the GPs. CNJ has not shown what proportion of its conveyed properties would, upon liquidation in the absence of the Rail Act, have been condemned by public authorities at little or no selling expense, or how much or how little litigation expense would have been incurred. Without an informed estimate from CNJ, we apply the figure of 10% as the best available calculation of the expense attributable to brokers' commissions, marketing agents' fees, and salaries of in-house sales personnel.

(b) *Post-1977 In-House Disposition Costs.* The GPs would have us deduct $3.7 million in "additional management costs" that they estimate would be incurred in completing "the disposition of CNJ's conveyed real estate" in the fourteen years after May 31, 1977, the date by which all facilities and equipment would have been sold. GPs Opening Brief O-19. Discounted to present value, this deduction would amount to about $2.5 million as of April 1, 1976. Testimony of Russell F. Murphy, a consultant and former USRA Director of Financial Analysis, reveals that this deduction reflects the estimated cost of legal, accounting, finance, and personnel departments attributable to CNJ's

conveyed real estate after May, 1977, Murphy Testimony, February 16, 1982, at 24, but does not include expenses of the Trustee and his staff, an item for which the GPs concede no deduction should be made, *id.* at 46b n.3. In setting this amount Murphy sought to avoid duplicating Tesh's calculation of the salaries and expenses of an in-house staff assisting in the sale of real estate included in his deduction of 10% from the proceeds of developable properties and 15% from those of abutter properties. Still, his result is a top-heavy setup of four management departments, in addition to the Trustee and his staff, lingering on for fourteen years to supervise a limited number of in-house personnel charged with assisting CNJ's marketing agent and independent brokers in disposing of a dwindling supply of real estate. We conclude in Section III.B.3, *infra*, that 55% of the real estate would have been sold in the first two years, 85% by the end of the fifth year, and the rest by the end of the eighth year of disposition. We are convinced that ample provision has been made by Tesh for all in-house expenses that would have been incurred by CNJ in disposing of the small balance of its conveyed real estate remaining after the fifth year. The few remaining in-house personnel could surely have reported directly to the Trustee, and their compensation could have been handled by his staff. Murphy's additional deduction for "management costs" through the fifth year is considered and substantially reduced in the portion of the opinion dealing with liquidation organization and disposition costs. All such costs after the fifth year are disallowed.

(c) *Surveys, Transfer Taxes, and Attorneys' Fees.* On behalf of the GPs, Tesh estimated that an additional 2% should be deducted from gross real estate proceeds to account for "the seller's customary share of closing costs, such as transfer . . . taxes and closing attorney's fees, as well as the costs of performing surveys, as necessary". Tesh Testimony, February 16, 1982, at 18. CNJ reports that in selling almost $21 million worth of retained real estate it has expended only $140,000 (or about 0.7%

of total proceeds) in legal costs, exclusive of a pending condemnation case,[33] nothing for surveys or title searches, and nothing for transfer taxes. CNJ argues that surveys, like title searches, are ordinarily paid for by the buyer in the New Jersey real estate market, and that transfers by a bankruptcy Trustee are exempt from the 0.35% New Jersey transfer tax. Tesh admitted in deposition that he had assumed CNJ was not in bankruptcy and hence was liable to pay the transfer tax. 2 CNJ App. at 1641. It seems more likely that CNJ would have been in reorganization at the relevant time, and thus would qualify for the exemption granted to transfers by "a receiver, trustee in bankruptcy or liquidation, or assignee for the benefit of creditors" in N.J.S.A. 46:15-10(g) (1982). We find therefore that no transfer taxes would have been incurred, that some of the cost of surveys would have been reimbursed by buyers, that closing attorneys' fees would have been incurred, and that legal fees would have been incurred in connection with condemnation, for a combined deduction of 1% of gross proceeds.

3. *Discount to Present Value*

We here discuss whether the proceeds of CNJ's real estate estimated to be realized after April 1, 1976, should be discounted to their value as of that date, and, if so, by how much.[34] We shall do this under three principal subheads:

(a) Should there be such a discount as a matter of principle?

(b) If so, when and in what amounts would the proceeds of the sale of real estate have been realized?

(c) If so, to what extent is the amount otherwise deductible in order to arrive at the present value of future proceeds offset by appreciation from the appraised values as of April 1, 1976?

We shall also deal briefly with related matters such as real estate taxes, other holding costs and interim income during the holding period.

(a) *The Need to Discount.* Admittedly, the normal method of finding the market value of a parcel of real estate being condemned is to determine its "market value" on the date of taking, usually on the basis of extrapolation from sales of comparable parcels. No discount is taken for the fact that in the real world the owner will often spend some months finding buyers and negotiating the best price even if only one parcel is being sold. The typical appraisal methodology avoids discounting by simply assuming that a willing buyer is available as of the date of the condemnation. The cases do not explain why such an assumption is made. Perhaps the matter is regarded as *de minimis*, since the prospective condemnee would often have started his hypothetical quest for purchasers and begun negotiations with them before the actual taking and sale could have occurred almost immediately thereafter. Perhaps the thought is that prediction of the actual sale date for a single parcel is beyond the scope of reasonable estimate. Perhaps it is deemed unfair that an often unwilling condemnee should be penalized for the time it would have taken him to find a purchaser. In any event we have been cited to no instances in which a court has considered the application of a discount in cases of this sort.

Here all parties concede that CNJ could not have sold the more than 3000 acres of its conveyed real estate as one parcel except perhaps to a wholesaler who would have broken up the tract into parcels, such as the bulk buyer hypothesized by the I.C.C. in the remand in the *New Haven Inclusion Cases, supra,* 334 I.C.C. at 60-61; 399 U.S. at 468-73.[35] The GPs contend the real estate would have been sold as 364 parcels; CNJ estimates it would have been sold as 962. Both sides agree that the process would have consumed some years, and the GPs argue that the normal implicit assumption of a willing buyer in existence as of the condemnation

date is inapplicable. The GPs contend that under such circumstances the proper course is to estimate the amount of sales in each year, add interim income and appreciation if any to the estimated date of sale, deduct taxes, other holding expenses, and selling costs to the same date, and then discount the result to value as of April 1, 1976.

This seems indeed to be the accepted method of appraisal in the case of large tracts of raw land which are proposed to be subdivided and sold. *See United States* v. *Iriarte,* 166 F.2d 800, 804 (1st Cir.), *cert. denied,* 335 U.S. 816 (1948); *Drakes Bay Land Co.* v. *United States,* 459 F.2d 504, 510-11 (Ct. Cl. 1972); *United States* v. *100 Acres of Land,* 468 F.2d 1261, 1266 (9th Cir. 1972), *cert. denied,* 414 U.S. 822 (1973); American Institute of Real Estate Appraisers, The Appraisal of Real Estate 64-65, 148 (7th Ed. 1973); College of the Fellows of the American Society of Appraisers, The Applicable Method for Valuation of Undeveloped Land for Which There Is No Current Market Value, 1975 ASA Valuation 88. A good deal of CNJ's land would have required much time and work to be sold for the projected highest and best uses.[36] As to such land there would seem to be no question that the discounting process proposed by the GPs is required. The deferral in the receipt of payment is as much a cost as expenditures required to place the property in its highest and best use, which clearly must be taken into account, *see* 4 Nichols, Eminent Domain § 12.3142[1], [2] (Rev. 3d ed. 1981); Norvell, Property, 35 N.Y.U. L. Rev. 1494, 1500 (1960). However, we agree with the GPs that this process should extend not only to the indeterminate amount of land requiring extensive work in preparation for sale but to all CNJ's real estate.

The cases stress that where the taking is of many parcels, the sale of which would stretch over several years, it is inappropriate to make an award on the basis of summing the market values of each on the date of the taking. *See Morton Butler Timber Co.* v. *United States,* 91 F.2d 884, 888 (6th Cir. 1937); *United States* v. *Cunningham,* 246 F.2d 330, 333 (4th Cir. 1957); *United States*

ex rel. TVA v. *Phillips*, 50 F. Supp. 454, 456 (N.D. Ga. 1943); *City of Caldwell* v. *Roark*, 437 P.2d 615, 617-18 (Idaho 1968). CNJ cites no contrary authority. It relies rather on the statement of its witnesses Hannoch and Heaney, 2 CNJ App. at 19, corroborated by that of Professor Stewart C. Myers, 2 CNJ App. at 1166, that "the value of real estate is created by the anticipation of future benefits and the appraisal seeks to reduce those anticipated future benefits to their present value" and that "[t]he comparable sales utilized in the appraisal process provide a measure of the present value of all anticipated future benefits with respect to the given property which was the subject to the sale." We do not doubt that this is true with respect to what a buyer would pay for any particular parcel; what it ignores is that when condemned property consists of many parcels, the condemnee would not receive the payments until some time after the condemnation date. In other words, the Hannoch-Heaney analysis would be valid only if they had been able to predict that sales prices would have risen sufficiently over their appraisal values to counteract the factor of time lag in receipt of the proceeds. This also is the answer to CNJ's seemingly pertinent question why a parcel in its hands should have a fair value less than it would if owned by another. CNJ owned not simply one parcel but an immense tract incapable of sale as such, and it is chargeable with the time lag necessary to effect the sales of the many parcels in the tract.

Such precedents as there are with respect to railroads support the GPs. The most important are the *New Haven Inclusion Cases*, culminating in the Supreme Court's decision reported in 399 U.S. 392 (1970), which, although not condemnation cases, were treated by all concerned as if they were. In these hotly contested proceedings neither the parties, the Interstate Commerce Commission, nor the three reviewing courts, in one of which a member of this court participated, ever questioned that it was necessary to divide the property into parcels, estimate the amounts that would be received over a period of years, and then

discount for the time that this would take, 331 I.C.C. 643, 663 (1967). The ICC also followed a practice of discounting in *Chicago & North Western Transp. Co.-Abandonment between Ringwood, IL and Geneva, WI*, 363 I.C.C. 956, 960-61 (1981), affirmed without discussion of this point in *Chicago & North Western Transp. Co.* v. *United States*, 678 F.2d 665 (7th Cir. 1982).

The CNJ advances a special contention with respect to the GPs' applying a discount to the $2,091,220 base value of land in 9 counties where such values were stipulated. The stipulation stated that the figures "represent the market value, *i.e.*, most probable selling prices, as of April 1, 1976, for nonrail use of all the parcels of land stipulated to have been conveyed by CNJ in the counties listed," Sp. Ct. Rptr. N-37753. CNJ contends that the stipulation prevents the GPs from arguing that it would have realized not these prices but only their discounted amounts. However, the stipulation was stated to be predicated on various assumptions, one being:

> the values are the sum of individual parcel appraisals, and the parties recognize that they take different positions as to whether the availability for sale of CNJ's conveyed property (other than the single parcel considered by each appraisal) and/or the property conveyed by the other transferors would have affected the final net realizeable nonrail use value of the property covered by this stipulation . . . .

Although this qualification seems to have been framed primarily to preserve the issue of glut, the language is sufficiently broad to permit the GPs to argue that the sum of individual parcel appraisals is not the correct measure for any reason, including that here considered.

(b) *The Pace of Disposal.* The GPs presented evidence with respect to the pace of disposal through two sets of witnesses. Four officers of Eastdil Realty Inc., a specialist in real estate and

management services, testified with respect to the estimated pace of sales for CNJ's developable properties.[37] Harry A. Wiedeman, a Conrail real estate manager, and Alf Moody, chief real estate appraiser for USRA, determined the pace at which the Transferors' abutter properties could have been sold. The result of their studies is represented by the following:[38]

GPs' Estimate of Pace of Sale of CNJ Real Estate
(in constant 1976 dollars)

Year	Developable*	20% Abutter	15% Abutter	Total	Total % Sold
1	4,836,598	731,909	907,217	6,475,778	26%
2	3,786,522	585,527	771,181	5,143,230	20%
3	2,781,975	468,422	655,504	3,905,901	16%
4	633,380	374,737	557,178	1,565,295	6%
5	633,380	299,790	473,601	1,406,771	6%
6	663,380	239,832	402,561	1,275,773	5%
7	617,318	191,866	342,177	1,151,361	5%
8	528,979	153,492	290,850	973,321	4%
9	447,202	122,794	247,223	817,219	3%
10	167,943	98,235	210,139	476,317	2%
11	96,910	78,588	178,619	354,117	1%
12	96,910	62,871	151,826	311,607	1%
13	96,910	50,296	129,052	276,258	1%
14	83,260	40,237	109,694	233,191	1%
15	17,665	32,190	93,240	143,095	.5%
16	0	128,759	528,360	657,119	2.5%
	15,458,332	3,659,545	6,048,476	25,166,353	100%

* Eastdil Testimony, Feb. 16, 1982 at 41.

Taking the two types of properties together, the estimates were that CNJ would have sold 62% of its real estate in all counties in the first three years and that even after ten years, 7% of its properties would have remained unsold.[39] The effect of applying the stipulated discount of 15.22% over so long a period is to reduce the GPs' estimate of the base value of CNJ's property by almost one-third.

CNJ did not offer a timetable of its own but submitted a long list of criticisms of the qualifications and methodologies of the GPs' experts. Although we believe a good many of CNJ's criticisms are well founded, we are satisfied that the GPs' projected time periods are excessive on other grounds.

A good starting point is the ICC's handling of the problem in the *New Haven Inclusion Cases, supra,* 331 I.C.C at 661. There the New Haven Trustees proposed a six year period for discounting to net present worth, which they recognized as being optimistic. Penn Central assumed that ten years would be required. The Commission adopted the Trustees' figure.[40]

More important than this is the GPs' failure to take account of the fact that CNJ would not have had to wait until April 1, 1976, to start lining up purchasers. In the *Rail Use Opinion,* 531 F. Supp. at 1311, dealing with properties that would have continued in rail use, we said:

> The process of disposing of rail properties would have begun in February 1973. Studies by acquirers of the properties and negotiations would have taken ten to twelve months, and ICC deliberations would have taken twenty to twenty-four months. Taking into account the possibility of judicial review, the properties would have been conveyed about April 1, 1976.

The considerations underlying that conclusion apply with equal force to the properties here at issue. We find that in the absence of the Rail Act the CNJ Trustee would have continued to negotiate with the State of New Jersey until say November 1, 1974, but that if these negotiations had not culminated in an agreement by that time—an assumption on which the GPs necessarily ask us to proceed—the Trustee would have filed the necessary abandonment applications[41] and begun the planning and negotiations which would be a necessary preliminary to sale. While we recognize that negotiations are hindered by even slight uncertainty whether a seller will be able to deliver, the Trustee could have

done much preliminary work. The contrary spectacle, urged by the GPs, of the Trustee sitting on his hands until April 1, 1976, and doing nothing in the way of starting dispositions conditioned on orders of abandonment he was practically certain to be able to obtain, is utterly unrealistic.[42] Taking similar factors into account, Hannoch and Heaney, in the course of explaining why their "market value" approach was advantageous in eliminating such uncertainties as future sales prices and the time of sale, went on to say, 2 CNJ App. at 20 n.*:

> However, based on our knowledge of the properties and advice from counsel that we may assume that CNJ would have had an approximately two year period prior to April 1, 1976, to begin marketing activities looking toward sales commencing April 1, 1976, we believe that properties representing well in excess of half of the total values estimated could have been sold on or promptly after such date. (2 CNJ App. at 20).

A second factor is that CNJ would have concentrated its attention on the most valuable parcels. A sale of even 15% of the acreage in Year 1 thus might well involve 35% of the value.

A third common sense observation concerns the exceedingly long time estimated by the GPs to be required for the sale of abutter properties. For reasons explained in earlier portions of the opinion, these properties are difficult to sell in the sense that there are only a few potential buyers; they are sold not by advertising campaigns or by canvassing long lists of companies that might be interested in acquiring property in the area but by direct communication with a handful—often as few as one, two or probably at most three—potential buyers. The paucity of buyers would, of course, have a negative effect upon the price and the appraisal witnesses properly took this into account. But we fail to understand why that factor should prolong the period of negotiation to as long as 16 years; if anything, it should shorten this. As Hannoch testified, "if [the adjoining property owner] is going to

buy it, he's going to buy it and if he's not, he's not." 33 GPs Supp. App. at 426. Counsel for the GPs suggested at argument that the sale of this kind of property would require a salesman who would not content himself with a couple of conversations "across the fence" but would cultivate the prospective buyer, go out to his home, and drum the advantages of the purchase into him. We do not know whether such hard sell tactics are effective but, if they are, a few years of such treatment would suffice. We suspect that the long periods that have been required to sell abutter properties in the case of railroad abandonments are due to the fact that the probable proceeds hardly merit the effort or to the fact that the properties could not be sold at all.

We conclude that the GPs' efforts at scientific forecasting of the pace of sale are unrealistic and produce incredible results. We think that, taking the above factors into account, a more realistic schedule would be:

Year 1—35%[43]
Year 2—20%
Year 3—10%
Year 4—10%
Year 5—10%
Year 6— 5%
Year 7— 5%
Year 8— 5%

While we recognize that some of the abutter properties would never be sold, sufficient allowance for this has been made by Van Horn's elimination of certain properties as valueless.

(c) *Appreciation.* As indicated, the GPs' theory, which we have adopted, is that if CNJ's parcels of real estate are to be valued at what prospective buyers would have perceived their value to have been on April 1, 1976, a determination must be made as to when these proceeds would have been received, and these proceeds less real estate taxes and other holding costs plus interim income are then discounted back to April 1, 1976. An

important item of interim income is any appreciation in the value of the parcels that would have been realized over the value perceived on April 1, 1976. This is particularly clear when, as here, the discount rate is high, reflecting a considerable allowance for inflation. To the extent that CNJ's real estate appreciated in an amount equal to the inflationary component of the discount rate, that component would be wholly offset.

In their Table 1 comparing their own and the CNJ's nonrail use value of the conveyed properties by asset account and item of expense, GPs Opening Brief at B-7, the GPs, apparently acknowledging this, propose the addition of appreciation of 0-5% per year. However, they do not indicate where they have landed within this broad range and do not make any attempt to quantify it or show any addition for it. The testimony of their expert Eastdil does little to clarify this. At one place Eastdil states:

> In projecting the revenue that the sales of the developable properties would have produced over time, we considered the possibility of price appreciation between April 1, 1976 and the dates of the projected sales contracts.

Eastdil Testimony, February 16, 1982, at 37. However, the immediately succeeding portion of the statement says:

> Such a projection of future appreciation depends largely upon how buyers and sellers perceived future market developments as of April 1, 1976.

The experts concluded that "most of the markets in which Transferor properties were located exhibited no potential for price appreciation during the projected disposition period", *id.* at 38, the only exception being industrial properties in Northern New Jersey (Non-Central Cities), where a 3% annual appreciation rate was used, two of the counties (one stipulated and one contested) where a 5% annual rate was used for commercial properties and a third stipulated county where that rate was used for

both residential and commercial use, *id.* Eastdil stated that "[t]he anticipated appreciation to be applied to our sales revenue projections is reflected in the discounted cash flow analysis submitted by other witnesses", *id.* at 39. However, the only example we have found of this is the Wiedeman-Moody study on the abutter properties where, although the authors believed that "[i]n general, once abutter right of way has been offered for sale, it is not possible to sell the property for a higher price, even at a later date", Wiedeman Testimony, February 16, 1982, at 17, they seem to have applied an Eastdil overall appreciation rate of 2.5% per annum to increase the base values, *id.* at 17-18, as supplemented.

CNJ has done little to help us understand either what was done by the GPs or what it thinks should have been done. It stressed that Eastdil did not investigate what had actually occurred, something literally impossible since the conveyed properties were not offered for sale, but was interested only in "what persons in 1976 are claimed to have expected appreciation to be". CNJ Opening Brief at 277. Beyond that and pages of potshots at various GPs witnesses, CNJ contents itself with a statement of GPs witness Barkan that land values in April, 1976 were depressed, but had "started to move out of that depression in the latter part of the seventies", 2 CNJ App. at 1232, and a statement of GPs witness Von Ancken that 1976 was one of the lower periods in valuation and that since then there had been a tremendous upward push in the value of industrial land in New Jersey. Against this the GPs cite statements by CNJ witness Van Horn that only a small degree of appreciation occurred in the Elizabeth area from 1974 to 1979, 39 GPs Supp. App. at 48E, and by CNJ witness Hannoch that during the latter half of the 1970's "there wasn't a big change in land values in downtown Newark, and in many instances, they were down rather than up", 33 GPs Supp. App. at 137.

Eastdil's method is only a partial method of measuring appreciation for the purpose here relevant. To the extent that otherwise

determined base values were factored upward to take account of appreciation as perceived on April 1, 1976, that is well and good but not sufficient. Take, for example, a property whose base value without allowance for appreciation would have been $100,000. If it was estimated to be sold in the third year and it was one of the few cases for which a 5% allowance for appreciation would have been made, it would be assigned a base value of $115,762 and that much appreciation would have been credited. If, in fact, property values actually rose so that its sales price in the third year would be $150,000, the additional $34,338 should be taken into account. Such considerations apply with even greater force where little or nothing was added to base values for appreciation perceived on April 1, 1976.

The GPs might answer that even if the answer to our question is "Yes", such recognition is impracticable, since it would involve a revaluation of the inventory of unsold properties at the end of each year. CNJ could reply with Hannoch's and Heaney's caution, cited above, that avoidance of any need for this is one of the great merits of their "market value" approach. We find that, as a matter of judgment applied to the record, 3% per annum should be added to real estate base values to reflect appreciation not taken into account in the GPs' figures.

Other Factors. We deal here with three subjects related to holding the real estate during the period required for sale—property taxes and other holding expenses on the negative side and interim income (other than appreciation) on the positive side.

(i) *Property Taxes.* Chief among the real estate "holding costs" that would have been incurred annually by CNJ for each unsold parcel were local property taxes.[44] CNJ would become liable for these taxes when it discontinued rail operations on its properties. For the GPs, Tesh produced a table of average effective tax rates as of April, 1976, in the 15 counties in which CNJ's conveyed properties were located. These ranged from 2½% to

6¼%. Tesh then applied the county-wide rates to CNJ's remaining real estate inventory over the projected period of disposition, keeping effective tax rates level but taking appreciation of the real estate into account. For CNJ, Van Horn made a similar computation, arriving at an overall effective rate of just under 4%, slightly higher than Tesh's overall effective rate. We adopt the GPs' figures.[45]

Two points of dispute remain. First, CNJ would have us reject Tesh's assumption that 1976 property tax rates would have continued without diminution into future years. Tesh introduced tables showing a mixed pattern of increases and decreases in local effective rates from 1973 and 1976 and testified that as of April 1, 1976, higher effective rates would have been predicted. We adopt the compromise position that effective property tax rates would have continued unchanged for the period of real estate disposition. Second, Van Horn noted that some delay could be expected before the local authorities would get around to putting CNJ's properties back on their tax rolls. While that may have been CNJ's actual experience with its retained real estate, it is a minor and unquantifiable item. Accordingly we follow the GPs in computing property tax liability as of April 1, 1976.

(ii) *Insurance, Maintenance, and Security Expenses.* The GPs estimate an annual deduction for miscellaneous holding costs of 1% of the base value of the remaining unsold real estate. On behalf of CNJ, Van Horn calculated that for retained real estate such costs had included $50,000 annually for insurance, $1,256 annually for security, and one-time expenses of about $9,000 for maintenance, alterations, and utilities. Without an estimate of the value of CNJ's retained real estate, we cannot derive from his testimony a percentage comparable to that put forward by the GPs for the conveyed properties. The GPs' figure of 1% per annum is within reason for the many necessary expenses of insuring, protecting, and maintaining unsold properties, and will be deducted from the value of real estate inventory over the disposition period.

(iii) *Interim Income.* Tesh, testifying for the GPs, estimated interim income from leases on the conveyed properties at $557,000 in the first year and declining thereafter with the value of real estate sold. Van Horn, using CNJ's inventory of conveyed leases, computed interim income at $778,500 for the first year. All but $38,000 of the difference was accounted for when Tesh explained that he disregarded income from leases that would terminate on cessation of rail operations, and Van Horn explained that he included such income. Tesh's assumption is consistent with nonrail use valuation and thus is the correct one for this case. We resolve the remaining $38,000 difference in the GPs' favor. Their witness used data from the leases in Conrail's possession, while Van Horn relied on an inventory of leases in CNJ's possession.

CNJ disputes not only the initial figure for annual interim income but also the rate at which that figure is applied to declining real estate inventory in future years. Neither party attempted to predict when the individual leased parcels would be sold. Instead, Tesh estimated that interim income would decline in proportion to the value of real estate sold, while CNJ argues that "loss of income from such typical types of railroad leases as crossing agreements would more plausibly appear to relate to the rate at which acreage is conveyed rather than proceeds received", CNJ Opening Brief at 304 n.*. Once leases contingent on continuing rail use are excluded, however, interim income would follow more closely the value of property than its size. Tesh's methodology for reducing the amount of interim income in years after 1976 is therefore approved.

The absolute amount of all three of these items must, of course, be recalculated to take account of the shorter holding period we have determined.

IV.

FACILITIES AND OTHER ASSETS

A. *Ballast and Fill*

The CNJ and GPs vary greatly on the value assigned to the ballast and fill material underlying the CNJ's tracks. Based on the testimony of Storm, who has observed the removal of ballast and fill from the CNJ's conveyed lines by Conrail, the CNJ has valued this material at close to $2.3 million. CNJ argues that Conrail's sale of this material demonstrates its positive value and that the CNJ would have had an advantage in marketing these materials in urban New Jersey due to a lack of fill sources in these areas.

Storm valued the ballast and fill by adjusting downward the market price on April 1, 1976 of $1.00 per cubic yard. Storm made a "blanket adjustment" of 70 percent for fill (down to $.30 per cubic yard) and 50 percent for ballast (down to $.50 per cubic yard) to account for any difficulties in removing and marketing this material. CNJ argues that this downward adjustment accounts for all the problems of removal, such as problems of access, compaction of material, and clearance of trees and brush. Storm's prices for ballast and fill were multiplied by the amounts of these materials that Storm estimated were available under CNJ's tracks (estimated to be 6.4 million cubic yards of fill and 754,435 cubic yards of ballast) to reach a total value of $2,294,000.

The GPs contend that the ballast and fill material has no value. The GPs note that none of the four valuation studies of the CNJ assigned any value to the fill and that only two of these studies, the Wyer Dick study and Peabody study, assigned any value to ballast.[46] The GPs contend that a zero value for ballast and fill is warranted because removal and transportation costs preclude the realization of positive value from their sale. The GPs point out that the narrowness of CNJ's roadbed, the height of the embankments involved, the compaction of the top layer of ballast and fill,

and the presence of trees and brush on many embankments would have made removal difficult in many locations.

The GPs also attack Storm's testimony and contend that it is inconclusive with respect to the value of ballast and fill. The GPs argue that Storm's testimony with respect to his observation of removal operations does not show how much fill was removed, who was removing it, what happened to it, or if any price was paid for it. Storm could not testify conclusively that Conrail was paid anything for the ballast and fill removed from CNJ's conveyed lines. *See* Storm Deposition, March 21, 1982, 1246-1262, 35 GPs Supp. App. at 311-26.[47]

We agree with the GPs that the CNJ has failed to prove that its ballast and fill had positive value. The testimony of Storm and his associates did not establish why Conrail removed this material or if Conrail was able to remove this material at a profit. The CNJ has also failed to support its assumption that the downward adjustment of the $1.00 per cubic ton takes into account the considerable problems of removing the fill. The CNJ would have faced problems of clean-up after removal and of possible erosion from the removal sites. Storm did not consider these problems in giving this material a positive value. Storm Deposition, April 15, 1982, at 2130-32, 35 GPs Supp. App. at 517-19. We also find it highly significant that none of the four studies gave any value to fill and that two of the studies placed a small value on the ballast while the two other studies found it to be worthless. Because of the inability of the CNJ to present convincing evidence of past sales or specific data regarding the market for ballast and fill in the relevant areas, we conclude that the value of ballast and fill is zero.

B. *Ties in Track*

Another major disagreement between the parties concerns the value of the ties in the CNJ's track. The CNJ contends that its ties have value for rail reuse and for landscape purposes, and it has valued these ties at $5,130,000. The GPs contend that the

glut of ties that would have resulted from the dismantlement of the Transferors in the absence of the Act would have made the CNJ's used ties valueless. The GPs also argue that the CNJ overstated the number of ties suitable for rail reuse and use in landscaping.

CNJ conveyed 1,295,155 mainline ties and 641,867 ties in yards and sidings. Of the mainline ties, Storm concluded that 50% were marketable for rail reuse at a net price of $5.00 per tie and that the remaining 50% were marketable for landscape use at a net price of $3.00 each. Of the ties in yards and sidings, Storm concluded that 50% would be reusable as landscape ties but that only 6,700 would be suitable for rail reuse. Storm based his tie classification upon track inspection, his review of CNJ subsequent tie replacements, and his general experience. He assumed that all ties suitable for reuse would be purchased for reuse.

The GPs assigned no value to ties based on the opinion of their expert Mewhinney. Mewhinney is president of Gillis & Co., one of the oldest and largest marketers of used and industrial ties in the country. Mewhinney testified that the number of ties entering the market in the absence of the Act, which the GPs estimated to be 9.9 million ties, would have flooded the market and prevented the Transferors from realizing any value for their used ties. Mewhinney testified that the used tie market for rail reuse is limited because railroads install new ties in main tracks and cascade their used ties into yards, sidings, and low density lines.[48] Mewhinney also testified that it was his experience that dealing in landscape ties was unprofitable. This testimony led the GPs to conclude that CNJ would have left its ties along its roadbeds because the cost to remove and market them would have exceeded proceeds from sale.

For a number of reasons, we find neither the position of the CNJ nor the GPs to be tenable. With respect to the CNJ's evidence on ties, Storm could not fully explain how he concluded that over 1.3 million of CNJ's 1.9 million ties were fit for landscape or rail reuse. The GPs presented evidence that roughly

86% of these ties were over 10 years old and would not have been considered fit for reuse. Storm also was unable to cite specifics justifying his reliance on track inspections in determining if ties were fit for reuse and failed to provide the criteria he used in assessing the suitability of a tie for reuse.[49] Finally, Storm's conclusion that 1.3 million ties were reusable is contradicted by Mewhinney's testimony that usually only three reusable ties were found in each 39-foot rail section during the dismantlement of track. Mewhinney Deposition, April 8, 1982, at 275, 34 GPs Supp. App. at 174. On the basis of Mewhinney's rule of thumb of three reusable ties per 39-fooot rail section, the expected number of reusable ties per mile is 406. If this figure is multiplied by the amount of conveyed main line track (395.8), which would have contained the ties best suited for reuse, the number of reusable ties based on Mewhinney's rule of thumb would have been 160,756.

The GPs' evidence concerning ties does not fare much better than that of the CNJ. Mewhinney's conclusion that there would be no value for used ties is a result of the assumption that 9.9 million ties of the dismantled Transferors would have entered the market for used ties beginning on April 1, 1976. The GPs, however, cannot maintain that all of these would have been suitable for reuse and flood the market while arguing that only slightly over 10% of the CNJ's ties were suitable for reuse. If what the GPs assert is true with respect to the suitability of CNJ's ties, certainly far less than 9.9 million ties would have been suitable for reuse and actually been fit to market. The GPs also ignore the DeLeuw Cather study for USRA which concluded that there was a substantial demand for used ties in the northeast for rail and other uses. DeLeuw Cather, Development of Standard Usage Salvage Values 23-24, 3 CNJ App. at 418-19. Although this study was undertaken in the presence of the Act, its conclusion undercut the GPs' argument that the market for used ties was so limited that the ties from any one dismantled Transferor would flood it.

Appendix J

Our examination of the evidence on ties leads us to conclude that the CNJ could have sold a limited number of its ties profitably. We conclude that the most accurate valuation of the CNJ's ties was performed in 1978 by Rodola, who served as Wyer Dick's project manager for the study of the CNJ's liquidation value. Rodola participated in the inspections of ties in the 1974 RCNLD Study and apparently reviewed the inspection papers in preparing his 1978 valuation of ties. *See* Storm Deposition, March 18, 1982, at 793-94, 35 GPs Supp. App. at 175-76. He concluded that 162,335 of CNJ's ties could have been sold for rail reuse[50] at a net price of $2.50 per tie. Rodola assumed that 115,453 ties (10% of the remaining ties), could have been sold for landscape use at a net price of $2.00 per tie. The total value for reuse and landscape ties in Rodola's calculations was $636,743.

We find these calculations to be reasonable. The 162,335 ties that Rodola found would be suitable for rail reuse corresponds closely to the 160,756 ties that would be expected during dismantlement if Mewhinney's rule of thumb of three ties per 39-foot rail section is applied. Rodola's figure also is far closer to the 266,000 ties that the GPs found fit for rail reuse than it is to Storm's figure of 524,809. With respect to landscape ties, Rodola's assumption that 10% of the remaining ties could be sold for landscape use is warranted. Storm testified that he was aware of the demand for landscape ties, and the DeLeuw Cather Study for the USRA anticipated a substantial market for the nonrail use of ties. Given the heavy competition from the other dismantling Transferors, the assumption that the CNJ would have been able to sell only 10% of its ties into the nonrail market for ties seems reasonable.

We also conclude that the prices of $2.50 net for rail reuse ties and $2.00 net for landscape ties are reasonable. Based on Storm's testimony, the CNJ assumed a net price for rail reuse of $5.00 per tie and for landscaping of $3.00 per tie without attempting to take into account the effect of the increased supply from the other dismantling railroads.[51] Although we disagree with the

GPs' contention that glut would render CNJ's used ties valueless, we conclude that the effect of this increase in supply would be to drive down the prices of used ties. We are also less optimistic than the CNJ about the demand for rail use ties because these ties would not be placed in main lines but only in sidings and light density lines. Rodola's net prices correspond to our estimate of the probable effects of increased supply and decreased demand on the prices that CNJ urges this court to adopt. We conclude that $636,743 is the proper value to be placed on the CNJ's ties in track.

C. *Rail and Other Track Material (OTM)*

The CNJ and GPs are far apart on their valuation of rail and OTM.[52] CNJ values this material at $27.6 million; the GPs value it at $16.8 million. This disparity results from disputes over the quantities of rail and OTM to be reused as opposed to be scrapped, the marketability of these materials, and the scrap prices for the rail and OTM not suited for reuse.

1. *The Suitability of CNJ's Rail and OTM for Rail Use*

A substantial difference in the value of rail and OTM is due to the amount of these materials each party classified as suitable for rail reuse. Suitability for reuse is essentially an engineering question focusing on the actual physical quality of the rail to determine if it can be safely and economically relaid. To determine suitability, Storm developed the CNJ's rail classification system based on the table for headwear standards developed by the American Railway Engineers Association (AREA).[53] Storm developed four different classes of relay rail into which rail would be classified, depending upon the condition of the track.[54] His associate, Rodola, evaluated the condition of CNJ's track using headwear data from the Bechtel Study[55] and field notes from his own track inspections and from the inspections of others, including those of Storm. Rodola then classified segments of the

CNJ's track based on their condition into the four categories developed by Storm.

For each of the four track-condition classes, Storm developed a system to determine what percentage of rail of a certain weight would be suitable for reuse. For example, Storm determined that 70% of Class I track of over 130 pounds would be suitable for relay in main line track, 20% would be suitable for relay in branch lines, and 10% would be scrapped. Storm's system also made overall deductions in tonnage to account for track defects, such as engine burn, and a 5% deduction for wear and tear (by stipulation of the parties). *See* Storm, Assumptions for Classifying Rail, August 22, 1978, 34 GPs Supp. App. at 523.

For OTM, Storm assumed that its condition would follow that of the associated rail. If the rail in a particular segment of track was classified as relay quality, the OTM and turnouts in the segment were also classified as relay. There are two exceptions to this classification. First, all bolts, spikes, and rail anchors were assumed to have only scrap value. Second, Storm concluded that turnouts in yards were maintained better than the surrounding track in order to prevent derailments. *See* Storm Deposition, April 14, 1982, 1991-92, 35 GPs Supp. App. at 491-92. For the most part, however, the CNJ's classification of its rail determined the classification of its OTM.

Rather than rely on standards tied to the AREA table for headwear, the GPs developed their own system to classify rail. The GP's rail classification system did not focus on the engineering question of suitability, but mixed criteria to determine the fitness of the rail with marketing criteria not intended to evaluate the rail based on its condition. The GPs concluded that only rail which was suitable for reuse in main and important branch lines would have been sold for reuse. The GPs concluded that there was no market for any other quality rail, and they designed their classification system to eliminate all rail that could not be relaid in main lines.

The GPs' first criterion was to eliminate all rail which was less than 115 pounds.[56] The GPs concluded that this rail was too light for main track use and that even though it might be fit for reuse in yards, sidings, and light density branch lines, there was no market for this rail. According to the GPs, rail purchasers would have generated enough rail internally through the process of cascading to meet their needs for yards, sidings, and light density branch lines. The GPs classified all rail in this category as scrap.

The GPs' remaining criteria focus more on the actual condition of the track rather than its marketability. First, the GPs eliminated all rail which did not meet the vertical headwear limits for main and important branch lines under the AREA standards. Second, the GPs eliminated all rail which had been cropped twice. This rail was 36-feet in length and had already been removed twice from the track. Because the GPs concluded that this rail would not be suitable for reuse in main and important branch lines, they classified it as scrap. Third, the GPs focused on end batter—the wear and tear on the ends of rail caused by the wheel as it moves across the gap between rails that exists in bolted rail. The GPs classed as scrap all rail with end batter exceeding ¼ inch.[57]

The GPs' next criterion was controlled cooling. Controlled cooling is a process developed in the 1930's to help prevent internal defects from forming in rails. The GPs concluded that purchasers of used rail for main and branch lines would have insisted that the rail be controlled-cooled. In its analysis, the GPs assumed that all rail rolled before 1942 was non-controlled-cooled and classified pre-1942 rail as scrap.

The GPs' final criterion was defects per mile. The GPs concluded that rail with more than two defects per mile per year was not suitable for reuse. The GP's experts contend that industry standards call for the removal of track with this level of defects

and recommend that it not be relaid in main line track. Morgan/Gabriel Deposition, March 29, 1982, at 115-116, 34 GPs Supp. App. at 284-85.

For OTM, the GPs agreed with the CNJ that all bolts, spikes, and anchors should be scrapped. The GPs classified all joint bars as scrap because purchasers would have cropped and welded used rail and not had a need for joint bars. For turnouts and tie plates, the GPs assumed that the CNJ would have had enough reusable tie plates and turnouts to match the quantity of rail that was considered marketable for relay.

The end result of the two different approaches of the GPs and CNJ is that the GPs found far less of the CNJ's rail suitable for reuse. Based on our examination of the different methodologies employed, we conclude that the CNJ's approach is superior. The basic thrust of the CNJ's methodology was to focus on the actual physical condition of the rail based on inspections and the Bechtel data, to classify rail based on that condition, and to determine the percentage of rail within a class that could be reused based on knowledge of CNJ's rail. The GPs' methodology was to begin with the assumption that only rail greater than 115 pounds in weight and that was capable of reuse in main lines and high density branch lines would be suitable. The GPs then constructed criteria to weed out rail that did not fit this mold.

The problem with the GPs' approach is that suitability for reuse, which is essentially a question of engineering concerning the physical quality of the rail, became intertwined with its marketability, which is a separate but important issue. Rather than examining all of CNJ's rail to determine if it was suitable for reuse at some level according to industry engineering standards, such as the AREA headwear table, the GPs assigned the vast majority of rail that is in good physical condition to the scrap heap based on marketability. The CNJ's approach, an engineering analysis of the condition of the rail, was more appropriate to establish suitability for reuse.

There are also flaws in the GPs' methodology. The GPs used only the headwear limits for the main and branch lines in the AREA tables but did not apply the headwear limits from the lower end of the table to determine if CNJ's rail was suitable for use on lines that were not main or high density branch lines. Similar problems exist in the rail length criterion. AREA guidelines permitted use of less than 36-foot length rail in relay, and the Pennsylvania Railroad Specifications for Grading Secondhand Rail recognizes that less than 36-foot lengths are appropriate for relay rail in main line trackage. Morgan/Gunderson Study, January 31, 1979, at III-38, 3 CNJ App. at 427. The GPs assumed that no one would want this rail rather than determining if it is suitable for use. Two of the GPs' other criteria, end batter and defects per mile, are flawed because the practice of cropping rail before reuse would eliminate end batter[58] and many of the defects per mile.[59]

We also find fault with the GPs' controlled cooling criterion. The 1942 cut-off date was based on Morgan's belief that by 1942 all new rail going to Class I railroads was controlled-cooled. Yet, even Morgan conceded that controlled-cooled rail was used well prior to 1942. Morgan/Gabriel Deposition, February 16, 1982, at 94, 3 CNJ App. at 160. There is also no AREA prohibition against non-controlled-cooled rail, but only a recommendation that it be welded separately from controlled-cooled rail. Storm Rebuttal Testimony, June 2, 1982, at 17-18, 3 CNJ App. at 474. Finally, any defects in non-controlled-cooled rail should have appeared well before now.[60] Morgan's testimony shows that most defects would appear before 20 years. *See* Morgan/Gabriel Deposition, March 29, 1982, at 92-93, 3 CNJ App. at 158-159.

For OTM, we conclude that its condition will be the same as the rail it is associated with. If the track and rail in a given segment are in good shape, it follows that the OTM in that segment would have been well-maintained and suitable for reuse. We reach the same conclusion with respect to turnouts, despite

CNJ's contention that the turnouts in its yards are in far better condition that the rail it is associated with. The only evidence CNJ produced to support this contention is Storm's testimony that turnouts in yards were in better condition than the poor state of the rail in these areas in order to prevent derailings. *See* Storm Deposition, April 14, 1982, at 1991-92, 35 GPs Supp. App. at 491-92. CNJ never produced any data to substantiate Storm's opinion, such as inspection notes or data from the Bechtel Study, and in the absence of objective verification of his opinion, we conclude that turnouts are in the same condition as the rail with which they are associated. In determining the amount of rail and OTM suitable for reuse, we will use the CNJ's figures, and for turnouts we will assume that the percentage of turnouts and rail suitable for reuse will be the same.

2. *The Marketability of CNJ's Rail and OTM*

The major difference between the parties' values for rail and OTM results from conflicting views over how much of this material would have been marketable. The CNJ contends that it has proved the marketability of all of its rail and OTM that was suitable for reuse in accordance with the Stipulation Regarding April 1, 1976 Unit Price of Relay Rail and Reusable Other Track Material, Sp. Ct. Rptr. N-37336 ("Rail Stipulation"). The Rail Stipulation provides:

> 1. The unit price as of April 1, 1976, which is to be applied to all rail found suitable and marketable for relay on main lines, branch lines, or yards and sidings, is $207.50 per net ton.
>
> 2. The reuse unit price of other track material consisting of angle or joint bars and tie plates as of April 1, 1976 is $227.50 per net ton.

* * *

5. The parties hereto further agree that this stipulation in no way precludes or prevents the Government Parties from:

(a) introducing evidence concerning the quantities of the transferors' rail that would have been suitable for relay, suitable for reroller, and suitable for scrap purposes;

(b) introducing evidence as to how much of the rail classified as suitable for relay purposes would have been marketable at a relay price in light of the addition to the market of the amount of rail being disposed of by the transferors;

(c) introducing evidence that in transactions where other track material is sold together with relay rail, the price of the other track material per net ton would be the same as the price of the relay rail.

6. Likewise, this stipulation in no way precludes or prevents the transferors from introducing evidence contrary to the Government Parties' evidence referred to in paragraph 5.

According to the CNJ, the Rail Stipulation places on the GPs the burden of showing that rail suitable for relay use would not have been marketable.

The GPs contend that they have shown conclusively that the only rail that would have been marketable for reuse is the rail suitable for reuse in main and important branch lines. Morgan testified that rail purchasers would have generated enough rail that was suitable for use in yards, sidings, and light density branch lines through cascading when they replaced main line rail. Morgan/Gabriel Testimony, February 16, 1982, at 13-14. As a result, the only rail these purchasers would have been interested in is rail for main or branch lines. CNJ's rail already in yards and sidings would be in no better, and possibly in worse condition, than the cascaded rail of the purchaser. Applying this marketing criterion, the GPs eliminated as unmarketable all rail under 115

pounds, all non-controlled-cooled rail, and all rail that had been cropped twice because this rail would not be used on main lines or important branch lines. The GPs do not acknowledge the existence of a market for CNJ's rail that is suitable for reuse in light density branch lines, sidings, or yards.

After the GPs presented their evidence on marketability, the CNJ attempted to rebut this evidence with testimony of Storm. Storm concluded that demand exists for lighter rail based on evidence (1) that cascading of rail could not be expected to satisfy demand for lighter rail; (2) that Class I railroads had very substantial quantities of lighter rail in track; and (3) that the rail replacement standards of many carriers permit the use of light rail. The CNJ also points out that DeLeuw Cather concluded that lighter weight rail could be sold[61] and that the Missouri-Pacific continued to relay rail as light as 90 lbs. in all classes of its tracks. *See* Morgan/Gunderson Study, January 31, 1979, at III-34 to -36, 3 CNJ App. 424-26. Based on this evidence, the CNJ contends that it has shown that all of its rail suitable for reuse would have been marketable.

CNJ's final contention on marketability concerns fairness. CNJ contends that the Rail Stipulation recognized that there are numerous grades of rail relay and that the CNJ was not required to limit its claims to rail suitable for use in place of new rail. The stipulation price reflected an average price (less than what the CNJ would have proven for its best relay and more than the price for its worst relay) designed to simplify computation but not meant to alter the attractiveness of the lesser-grade rail to potential buyers by pricing it higher. According to the CNJ, the GPs are trying to deprive it of the bargain worked out in the Rail Stipulation by allowing it a low price for its best rail while denying it any compensation at all for lesser-grade rail. The CNJ contends that the Rail Stipulation requires compensation at the agreed price for its lesser-grade rail to balance out the lower price it agreed to for its best rail.

Determining the marketability of the CNJ's heavier rail is not difficult. For rail over 130 lbs., the parties agree that all of this rail suitable for reuse would be marketable.[62] Nor do the parties disagree substantially over the marketability of the 130 lb. rail that is suitable for reuse. The major differences stemmed from the GPs elimination of all rail that was non-controlled-cooled or that contained more than two defects per mile per year as unsuitable for reuse. We have already rejected these contentions of the GPs, and we conclude that there would have been a substantial market for this rail because its heavy weight would have made it attractive to purchasers for reuse in any class of track, including main lines.[63] We therefore adopt the CNJ's conclusion with respect to the amount of 130-lb. rail that would be marketable for relay.[64]

A more difficult issue is the amount of the CNJ's lighter rail which would be marketable. We agree with the GPs that there would have been virtually no market for this lighter rail. The GPs presented substantial testimony that railroads would not have been interested in the CNJ's lighter rail, which weighed from 70 to 100 lbs., because of the overwhelming use of heavier rail on main and important branch lines. *See* Morgan/Gabriel, June 2, 1982, at 7. Cascading of rail from these lines would have fulfilled the demand for rail to be relaid in light density branch lines or sidings. There also would have been substantial amounts of heavier used rail generated by the dismantling Transferors which would have been available to rehabilitating railroads for use on these lines that would have further lessened the need for CNJ's light rail.

We also find that Storm's testimony with respect to the marketability of CNJ's lighter rail is unconvincing. Storm's testimony that there is a substantial amount of lighter track in use and that the engineering standards of railroads allow its use does not prove that railroads would buy this type rail but only that they bought this rail in the past and consider it acceptable. The main examples Storm gave of purchases of light rail showed a limited

demand for rail weighing between 110 and 115 lbs. and not a demand for rail weighing 70 lbs. to 100 lbs. *See* GPs Opening Brief at H-32.

Finally, we reject the CNJ's fairness argument that the Rail Stipulation requires compensation for its lesser grade rail at the stipulated price. The language of the Rail Stipulation is clear that the issues of both marketability and suitability could be contested by the GPs, and the GPs properly presented evidence that this lighter rail was not marketable. Neither the letter nor the spirit of this agreement was violated. We hold that none of the CNJ's rail weighing 100 lbs. or less would have been sold as relay.

With respect to OTM, we conclude that the amount which CNJ would have sold is determined by the amount of rail sold. If a railroad purchased relay rail it would have desired the OTM necessary to install the purchased rail. We conclude that purchasers would have desired used tie plates and turnouts in the quantities needed to install with the rail[65] but would not have purchased angle bars or joint bars, because these are not needed in laying continuously welded rail.[66] For example, because the CNJ has proved that 89.8% of its rail weighing over 130 lbs. is marketable and suitable, an equivalent percentage of the total amount of tie plates and turnouts associated with the over 130 lb. rail should be valued as marketable and suitable.

We also conclude that the CNJ failed to prove that joint and angle bars could have been sold for reuse separate from the rail they were taken from. Storm made a judgment that such a market existed, but he was unable to provide any basis for his judgment. Storm Deposition, April 14, 1982, at 1974-75, 35 GPs Supp. App. at 478-79. A more reasonable judgment is that railroads could have generated the limited number of angle and joint bars needed to repair their jointed rail track through cascading. We hold that all of the CNJ's joint and angle bars should be treated as scrap.

Appendix J

3. *Summary of Conclusions on Suitability and Marketability*

We will not attempt to calculate the exact amounts and values of rail, OTM, and turnouts that we have determined would have been purchased. The determination of value is left to the parties to be calculated in accordance with this opinion. To summarize, we have concluded that the CNJ correctly determined the amounts of rail weighing 130 lbs. or greater that would have been sold at the relay price. We conclude that all of CNJ's rail weighing less than 130 lbs. should be valued as scrap (the price of scrap is discussed *infra* at Section IV.C.4.) For OTM, the amount of tie plates associated with the rail which would have been purchased for reuse should be valued at the reuse price. Angle bars, joint bars, bolts, spikes, and anchors should be valued at scrap. For turnouts, the turnouts accompanying rail purchased for reuse should be valued at the reuse price; the remainder should be valued as scrap.

The reusable rail and OTM should be valued at the prices set forth in the Rail Stipulation. We reject the GP's contention that they have proved that OTM and rail would have been sold together at $207.50 per ton.[67] The GP's experts testified that OTM and rail generally are sold together at the same price, yet they also stated that prices vary widely and that each sale is unique. Testimony of Mauro, Michaels, and Kovalchick, October 26, 1981, at 9-10, 4 CNJ App. at 732-34. This testimony is too inconclusive to warrant not using the stipulation price. To value turnouts, the parties should apply the incremental reuse values that both sides have agreed are appropriate. *See* Morgan/Gabriel Testimony, February 16, 1982 at 25; Testimony of Shannon, Meyer, Storm, Dunn, October 26, 1981, at 6-7 (submitted on behalf of EL).[68]

4. *Scrap Values*

The final issue in valuing rail, OTM, and turnouts is to determine a price for the material to be scrapped. The CNJ determined scrap prices by averaging quoted market prices for the various classes of scrap for the first six months of 1976. CNJ obtained its quotes from *Iron Age*, a weekly publication of steel prices, and each unit price reflects the average of twenty-six quoted prices. The result of the CNJ's methodology was to price scrap rail of random lengths at $84 per ton, scrap rail two feet and less in length at $96 per net ton, and scrap OTM and turnouts at $86 per ton.

The GPs' price for rail was determined in a multistage process. Ralph Michaels, an expert on the scrap metals industry, conducted research on the nature of the scrap market and the grades of scrap metal which could have been recovered from rail properties.[69] Dr. James Kneafsey analyzed the effect of glut on the scrap market for the GPs. Based on his analysis of historical trends in the scrap market, Kneafsey concluded that for each 1% increase in the supply of primary grades of ferrous scrap, there would have been a .5% decline in scrap prices. George T. Mauro used prices in the first three months of 1976 to determine a base price for scrap of $76 per net ton for rail and $85 per net ton for reroller rail. Mauro then applied Kneafsey's formula using the GPs' figures for the quantities of scrap that would have been generated by the dismantlement of other Transferors. Mauro concluded that the price of rail would have dropped to $71 per net ton and the price of reroller rail to $79 and $80 per net ton.

The analysis of scrap prices presented by the parties presents numerous problems, the methodologies of both the CNJ and GPs contain serious flaws. The most serious flaw in the CNJ's data is its failure to account for the effect of glut in the scrap market caused by the dismantlement of other Transferors. This flaw is mitigated to some extent because the effect of glut obviously is not as great in the scrap metal market as it would be in other markets

for railroad assets, such as in the market for reusable rail or for locomotives.[70]

The GPs' methodology also is flawed. Their model did not include any data on the export market even though it accounts for a substantial portion of the total market. The GPs also did not consider any sales to scrap dealers in their model because these dealers resell scrap to end users. The GPs failure to analyze the demand of scrap dealers ignores the possibility that these potential purchasers may have wanted to beef up their inventories of scrap.

Another serious problem in the GPs' methodology stems from their rail classification system. The GPs' rail classification system overstated the amount of rail from CNJ and the other Transferors that would have been scrapped. Mauro relied on these overstated figures to determine the impact of glut on prices in the scrap market caused by the dismantlement of the Transferors' lines. Although we cannot determine the exact effect on the GPs' scrap price caused by overstating the amount of rail that was to be scrapped, the obvious effect would be to lower the scrap price calculated using the GPs' model.[71]

Neither of the scrap prices presented is without flaws. We conclude, however, that the CNJ's methodology is less flawed and sets a fair price for scrap rail, OTM, and turnouts. The GPs' methodology simply is open to question on too many fronts. The CNJ's methodology was straight forward, and that it did not take glut into account is not fatal given that the effect of glut in the scrap market would not be as pronounced as it would be in other markets for the assets of dismantling Transferors. We also note that the price of No.1 railroad heavy melt, expressed in constant dollars, ranged from $73.343 to $168.99 per net ton during the period from October 1973 to April 1976. *See* Kneafsey Testimony, February 16, 1982, Table 1, 3 CNJ App. at 9. The price on April 1, 1976 was $89 per net ton. The CNJ's figures are in the lower end of the range of prices for iron scrap during the relevant time period, and we hold that the CNJ's scrap prices

should be used in determining the value of rail, OTM, and turnouts that would have been scrapped.

D. *Ties in Inventory*

The CNJ had approximately 190,000[72] new ties in its inventory, and the great majority of these ties were at tie treatment plants rather than at CNJ facilities. The CNJ contends that the liquidation value of its new tie inventory is equal to their cost, which is $1,723,172. The CNJ argues that no deductions should be made from this amount because no costs would be involved in selling ties that were already at treatment plants.

The GPs, based on Mewhinney's testimony, valued the CNJ's untreated ties at 75% of the prevailing raw materials price for ties in the Northeast and treated ties at 75% of the prevailing market price for new ties. The value arrived at is $866,732, which is $856,440 less than the inventory value. The GPs' lower value for ties stems from several sources. Mewhinney testified that railroads would not have been willing to disrupt normal purchases to obtain ties from the CNJ, which would limit the CNJ's market. The GPs argue that the untreated ties needed prompt treatment to avoid deterioration, which would force the CNJ to accept below market prices. The GPs also argue that shipping and handling costs would have driven down the realizable value both for treated and untreated ties. The effect of these factors was a greatly reduced value for ties.

We conclude that the value for new ties falls between the figures of the two parties. The CNJ cannot realistically say it would have incurred no costs whatsoever in disposing of these ties, yet we find it unreasonable for the government to argue that deductions are warranted for shipping ties to be treated when the vast majority of ties are located at treatment plants. We also find it unreasonable to assume that railroads would have had no interest in the CNJ's ties out of a desire not to disrupt normal supply channels. The precarious financial state of most railroads would certainly have made them interested in potential bargains on ties.

Our compromise is to value the CNJ's ties in inventory at 85% of their costs.[73] This reduction in price should account for the CNJ's selling and disposition costs as well as any reductions in price necessary to sell the ties. We hold that the ties in the CNJ's inventory are worth $1,464,696.

E. *Rail in Inventory*

The CNJ valued the rail in its inventory at $813,400. The CNJ assumed all rail listed in its inventory as relay would sell at the stipulated relay price, and it priced all rail listed as scrap in its inventory at the scrap price. The GPs valued all of this rail as scrap, contending that it was all secondhand rail of mixed sizes and weights that would not be purchased for reuse.

Due to a lack of evidence on the fitness of this rail for reuse, we hold that all of it should be priced as scrap. Neither side inspected this rail to determine its actual suitability for reuse. Storm merely assumed that all rail listed in the inventory by linear feet was relay and that rail listed by ton was scrap. He had no basis for this assumption because he did not inspect the rail. Storm/Dunn Testimony, March 19, 1982, at 894-95, 35 GPs Supp. App. at 230-32. All of this rail had been removed from the first position. There was also evidence that some of this rail was: (1) of odd lengths, *see* CNJ Workpaper 000390, 35 GPs Supp. App. at 562; (2) less than 130 lbs. in weight, *see id.;* (3) lying out alongside the CNJ's track, Storm/Dunn Testimony, March 19, 1982, at 903, 35 GPs Supp. App. at 239; and (4) specially drilled, *see id.* at 897, 35 GPs Supp. App. at 233. This evidence compels the conclusion that the rail should be valued at scrap. We conclude that this material has a net liquidation value of $275,248.[74]

F. *Other Materials and Supplies*

Outside of its new tie and used rail inventory CNJ also has a number of other asset accounts that have been grouped together under the name "Other Materials and Supplies." This category

mainly consists of CNJ's inventory of replacement parts for its equipment and used OTM and turnouts.[75] CNJ assigns a value of $1,537,585 to these assets, while the GPs argue for a value of $888,400.

The CNJ appraisers arrived at their figure by taking the book value of the other materials and supplies accounts and making a 40% across-the-board reduction. CNJ argues that the replacement parts easily could have been sold to the parties purchasing used CNJ equipment. With regard to OTM, CNJ contends that the GPs are bound by the prices they stipulated for OTM.[76] CNJ maintains that the government should value used turnouts at 75% of their cost to be consistent with their valuation of CNJ turnouts located in track. Finally, CNJ contends that it has anticipated any problems in marketing the remaining materials and supplies in its arbitrary 40% reduction of book values.

The GPs rely on their appraisers' detailed analysis of the asset accounts at issue. They contend that CNJ, rather than taking the time to conduct an individualized study of the accounts, adopted an arbitrary and unsupportable reduction in value. The GPs also refer to evidence that railroads rarely buy used parts from other railroads and that any sales would be expensive to consummate. After making adjustments for the difficulty of sale and the lack of demand for individual asset categories, the GPs appraisers' estimate of the aggregate value of CNJ's other materials and supplies came to about 35% of the book value of the asset.

We accept the GPs' premise that other railroads would be hesitant to purchase replacement parts from the CNJ. The GPs have presented sufficient evidence to indicate that the practice within the rail industry is to purchase such parts at the time new equipment is acquired. Even if purchasers of CNJ locomotives were willing to purchase the corresponding replacement parts from CNJ, we find that they would not have paid much more than the scrap value of those parts. We also find the GPs' particularized approach preferable to CNJ's arbitrary 40% reduction in

establishing the NLV of the remaining assets in the other materials and supplies category.

Turning to OTM inventory, we need not consider CNJ's contention that the GPs' valuation of OTM in track should apply with equal force to OTM in inventory. These stipulated values only apply to OTM that is sold for reuse. As we indicated in our discussion of OTM and turnouts located in track, these items could have been sold for reuse only to the extent that the corresponding rail would have been sold for reuse. Because we hold that the rail inventory would have been sold as scrap, OTM inventory must receive a scrap value as well. We also see no inconsistency in the GPs' valuation of the turnout inventory. Accordingly, we adopt the GPs' estimate of the value of other materials and supplies.[77]

G. *Miscellaneous Assets*

1. *General*

We have grouped within this category office furniture and equipment, police and fire equipment, and other miscellaneous items. CNJ argues that these assets have an aggregate value of $107,000. CNJ did not provide testimony as to the value of the individual items in its inventory or as to how much of its $107,000 figure is attributable to Police and Fire Equipment and how much to Office Furniture and Equipment. The GPs have estimated the value of the assets to be $20,573. The GPs' figure consists of $18,117 for Office Furniture and Equipment, and $2,456 for Police and Fire Equipment. CNJ values most of these assets by taking their value as listed on its books and reducing that amount by an arbitrary figure to reflect any difficulties that it would incure in selling them. For the most part the arbitrary adjustment is a deduction of 40% of the book values of the assets. While recognizing that the GPs take a particularized approach to these assets, CNJ contends that the GPs failed to inspect physically the assets to arrive at a reasonable NLV. The GPs counter

that they were unable to take physical characteristics of each asset into account because CNJ provided a list of these assets without any description of their condition or whereabouts. In addition, the GPs point out that the CNJ has requested $50,000 for assets which it has not even listed.[78]

Under Paragraph 2 of the Sixth Pretrial Order we required each Transferor "to file a statement by July 15, 1981 identifying and describing with particularity each asset transferred pursuant to the Rail Act which has not been the subject of an inventory stipulation and for which the transferor claims nonrail use value." We hold that with respect to the miscellaneous assets, CNJ has failed to comply with the Sixth Pretrial Order. While CNJ did provide an inventory listing for these items, this list is so lacking in essential details as to be of no use in any meaningful appraisal. In fact, virtually no descriptive information is set forth in the CNJ inventory list. In many cases there is no indication whether the desks, tables, chairs, and other furniture were made of wood or metal. There is also no way of determining the age, model, size, or condition of the typewriters, calculators, adding machines, air conditioners, space heaters, and other mechanical equipment listed. Therefore, we accept the GPs' valuation of these assets.

2. *Signals and Communications*

CNJ argues that signals and communications assets are worth $110,000. The GPs set the value of this category of assets, which includes freight locomotive radios, vehicular radios, and copper wire at $27,000. We find the GPs' analysis to be more credible and, therefore, adopt their figure.

A large part of the dispute between the parties results from differences as to the net value that should be assigned copper wiring that would be removed from these assets and sold separately. Storm estimated the cost of removal and disposition of this wire at 25% of gross value, resulting in a figure of $23.00 per

wire mile. Storm/Dunn Deposition, March 19, 1982, at 970, 35 GPs Supp. App. at 253. Wyer Dick used a $30.00 per wire mile figure to calculate the same kinds of costs as of 1968. The GPs on the other hand conducted a detailed analysis of the procedures and costs involved in removing and disposing of these assets which we adopt.

V. EQUIPMENT

A. *Locomotives*

According to both the GPs' and CNJ's valuation, locomotives represent by far the most valuable equipment account. Unfortunately, there is a wide discrepancy between the parties' respective figures. CNJ has valued the locomotives at approximately $7.9 million and the GPs have valued them at approximately $3.3 million.[70]

The fundamental explanation for this discrepancy is the parties' disagreement over how many of the 78 locomotives conveyed by CNJ would have sold for rail reuse or, alternatively, for scrap. Both CNJ and the GPs agree that CNJ could have sold at reuse prices its twenty high horsepower diesel road locomotives built in 1965 and 1967. The parties disagree, however, with respect to the remaining 58 locomotives which CNJ owned and conveyed, all switchers built between 1939 and 1953. Of these 58 units, CNJ contends that 32 would have been sold for reuse and 26 at about twice scrap value for their usable parts. The GPs, on the other hand, assert that they would have been marketable only at scrap prices.

In reaching their conclusion the GPs have assumed that only yard locomotives less than 15 years old would have been sold for reuse. Although CNJ has gone to great lengths in its briefs to attack the validity of this 15 year "breakpoint," such an approach is not particularly material because the 58 units in question were considerably older than 15 years. Rather, the appropriate

inquiry is whether CNJ could have sold for reuse any of its locomotives which in 1976 were between 23 and 37 years old.

The GPs assert that CNJ's older units would not have been marketable for reuse for three basic reasons. First, they contend that the older locomotives have been superseded by a "second generation" of diesel-electric locomotives built during the mid-1960s, and that by modern standards the older units are "technologically crude." GPs Opening Brief at K-9. Second, they contend that in 1976 there was a substantial surplus of locomotives due to a severe decline in traffic since 1973. Third, the GPs argue that wholly apart from the alleged surplus, as of April 1, 1976, the market would have been flooded by the release of the many locomotives not needed for the proffered lines of Penn Central, Erie Lackawanna, and Reading Railroads.

Although the parties disagree about whether the new "generation" of locomotives was built during the early or mid-1960s and whether it should properly be considered a "second" or "fourth" generation, it is clear that a new and better breed of locomotive did come on the market sometime in the 1960s. It is also clear than CNJ's 58 older units lacked many of the technological refinements found in the more modern models. Among these refinements were turbochargers, improved wheel slip control, solid state controls, alternators in place of direct current generators, improved traction motors, etc. CNJ does not seriously dispute that these refinements represented improvements in operating performance, reliability, and maintenance.

It is CNJ's position that by failing to consider that new technology may be incorporated into older units, the GPs have overstated the impact of technological development on the value of CNJ's older fleet. Although it certainly is possible to retrofit the older units with much of the most recent technology, it is doubtful that such a possibility would have significantly enhanced the value of these 58 units in 1976. Assuming that advanced technology can be successfully incorporated into older units to the extent that CNJ contends, there is little reason to believe that its 58 switchers

would have been attractive candidates for a retrofit program. The expense of technological improvements is most sensible in units with a substantial service life remaining, and this dispute concerns CNJ locomotives built from 1939 to 1953. The life expectancy of switchers such as CNJ's is not clear; a CNJ witness gave the national average age of yard switchers as something in excess of 30 years. In the light of the limited nature of yard work, we find that the life expectancy of the CNJ yard switchers was 30 years. The average service life of a road switcher would be somewhat less.

The CNJ units built between 1939 and 1942 would have been between 34 and 37 years old in 1976 and would have been near the end of their service life. The switchers built between 1950 and 1953 would have been between 23 and 26 years old, and would have had about one quarter of their useful years remaining. Units that old are not likely candidates for retrofit, but even if they were, the competitive position of the CNJ units was poor. CNJ owned no locomotives built between 1954 and 1964. Even if any of CNJ's 58 locomotives could have been modernized for reuse, they would have had to compete not only with comparable units, but also with the many newer units owned by other Transferors. In terms of reliability and maintenance, CNJ's units would not have compared well with the younger models.

The GPs' second contention is that a "substantial surplus" of locomotives existed in 1976 due to a simultaneous decline in traffic and increase in size of the national equipment fleet. Although CNJ's reply argument misses the mark,[80] the GPs' showing with respect to the alleged surplus is inadequate. As evidence of the surplus, the GPs merely observe that in 1975 originated tonnage and freight train miles had declined from 1973 levels while the number of freight cars and locomotives had increased by about 1%. Although originated tonnage levels reflect freight car requirements to some extent, and freight train miles reflect locomotive usage, the GPs' statistics do not reflect any clear trend in the industry.[81]

The GPs further argue that the alleged surplus is demonstrated by the fact that new locomotive acquisitions in 1976 were considerably lower than the preceding three years. The market for used locomotives does not necessarily parallel that for new locomotives; the evidence shows that installations of new locomotives have increased in certain years when installations of used units were declining, and vice versa. *See,* e.g., figures for 1962-1963, 1973-1974, and 1975-1976, 36 GPs Supp. App. at 179.

The GPs note that the market in which CNJ's locomotives would have been valued would have included not only CNJ's units, but also locomotives of Penn Central and other Transferors. The GPs contend that the proper approach in calculating alternative scenario nonrail use values is to follow a so-called "residual scrap model" and "price the property remaining in rail use by looking at a market affected by the simultaneous scrapping of all properties that would be withdrawn from rail use." They argue that as of April 1, 1976, the market would have been flooded with used rolling stock released by the other Transferors, and that potential buyers would have had their choice of good equipment at bargain prices.

An accurate assessment of the market effect of the Transferors' disposition of all properties withdrawn from rail use would require a detailed analysis of the amount, time and pricing of such dispositions. The court has heard no such evidence, but the difficulties of proof do not mean that the GPs' point should be ignored altogether.

The GPs have asserted, and CNJ has not attempted to rebut, that Penn Central, Erie Lackawanna, and Reading would have released some 1,652 locomotives not needed for their proffered lines. They further argue that, when combined with the units released by the other Transferors, this supply might have risen to 2,291 locomotives. Although the figures may be somewhat inflated, a lesser supply would have had a significant effect on the marketability and value of all rolling stock—especially older units such as CNJ's.

CNJ has failed to address the question of market demand. It assumes marketability for reuse with respect to all models, but makes no serious attempt to identify potential purchasers who might have paid the prices which CNJ suggests. The other Transferors would have had enough old units of their own for yard use. Certain railroads in the south or west might have been interested, but even if that market existed, CNJ's units would have had no competitive advantage.

The four EMD SW1 switchers built between 1939 and 1942 and two EMD NW2 switchers built in 1942 would have been between 34 and 37 years old in 1976. They had very few, if any, years of useful service remaining in 1976. With only 600 (SW1) and 1000 (NW2) horsepower, these units were underpowered by current standards. The Wyer Dick study made in 1968 for CNJ appraised these units at scrap value; it is not plausible that in 1976 a purchaser would have paid a reuse premium for any of them.

In the next category are fifteen EMD SW7 and SW9 switchers built between 1950 and 1952. These 1200 horsepower units were between 24 and 26 years old in 1976. In 1968, when these units were sixteen to eighteen years old, Wyer Dick found that they could have been sold for a total of $333,000, or $22,000 each. CNJ now contends that eight years later, with other bankrupt railroads abandoning many of their lines, these same units would have been sold for $60,000 each. That figure is unreasonable. We find that the valuation of CNJ's diesel locomotives and freight cars contained in the 1968 Wyer Dick study (Account 52) is credible and entitled to considerable weight. Prepared pursuant to orders from the CNJ reorganization court, the study was carefully executed—taking over two years and 2900 hours to complete and supported by thousands of pages of detailed workpapers. Each of CNJ's locomotives and freight cars was individually evaluated. This study represents the most thorough evaluation of CNJ's equipment in the record. While the Wyer Dick study placed its primary emphasis on age when evaluating

CNJ's locomotive fleet, the study also considered such factors as usage, potential for rebuilding and the condition of major components in making its evaluations. Weighing all factors, we find that eleven units built in 1951 and 1952 would have sold for reuse at Wyer Dick's price of $22,000 each. The four built in 1950 would only have been sold for scrap.

CNJ also owned eleven EMD GP7, 7P road switchers built in 1952. Wyer Dick determined in 1968 that there was a resale market for them at a price of $30,000 each. CNJ's contention that in 1976 they could have sold for $90,000 each is not reasonable. The GPs argue that all would have been sold for scrap. We find that six of the eleven switchers would have been sold for scrap, and the other five could have sold for $30,000 each over a period of time.

CNJ owned 26 ALCO RS2 and RS3 road switchers built between 1950 and 1953. For a variety of reasons, these were among CNJ's least desirable models. First, ALCO ceased domestic production in the late 1960s, making replacement parts difficult to obtain. Second, the unrebutted testimony of GPs' witness George P. Leilich shows that ALCO units are "significantly more expensive to maintain and operate than comparable locomotives" such as EMDs. Third, CNJ's own witness (Dunn) stated that EMD models are preferable to ALCO models because "they're better built, crews like them better and maintenance practices over the years have shown that the EMDs are less costly to maintain." Dunn also conceded on cross-examination that these 26 ALCO locomotives would have been cannibalized for spare parts rather than sold for reuse, 35 GPs Supp. App. at 152. Finally, the Wyer Dick study valued these units at scrap in 1968 and there is no reason to conclude that over the course of the next eight years these locomotives had become any more attractive to a purchaser for reuse. They should be valued at scrap.

The twelve high powered EMD SD35 road freight locomotives built in 1965 could have been sold for reuse. CNJ contends that the twelve locomotives were worth approximately $2.9 million;

the GPs' figure is just under $1.6 million. Wyer Dick's careful study appraised these locomotives at $2.18 million. We adopt its conclusion.

The final category embraces eight MD SD40 road freight locomotives built in 1967. The parties agree on marketability for reuse but differ on price. The CNJ valuation is approximately $2.16 million; the GPs' figure is $1.25 million. These 3000 horsepower locomotives, CNJ's newest and highest powered units, were unquestionably the fleet's single most valuable model. The Wyer Dick study appraised these locomotives at $1,971,000, a figure considerably closer to CNJ's valuation than the GPs'.[82] It represents the best choice under the circumstances.

B. *Freight Cars and Cabooses*

After locomotives, CNJ's 753 conveyed freight cars and cabooses represent the next most valuable equipment account. CNJ contends that 257 of its cars (including 29 cabooses) would have been sold for reuse, and that the conveyed fleet should be valued at $2,085,000. The GPs argue that only eleven cars (those fifteen years old or less in 1976) would have been sold for reuse, and that the conveyed fleet should be valued at $937,000.

The GPs contend that in the absence of the Rail Act the market would have been glutted with used rolling stock withdrawn from service by the other Transferors; they assert that Penn Central, Erie Lackawanna, and Reading would have released some 55,040 freight cars not needed for their proffered lines and that, combined with the units released by the other Transferors, the supply might have risen over 77,000. Although the court does not adopt these figures, the problem of market glut in the absence of the Rail Act cannot be ignored.

The GPs also argue that CNJ's conveyed equipment was undesirable to other railroads because of its advanced age, high maintenance cost, and poor reliability. This is supported to some extent by the evidence that CNJ's conveyed freight cars were in the worst condition of any of the Transferors.

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The normal life expectancy of boxcars, gondolas, and hoppers is 30 years; apart from the cabooses, this dispute primarily concerns 224 cars between nineteen and twenty years old in 1976. On the basis of age alone, these units are not too old for reuse.

CNJ's strongest argument is that in the mid-1970s there actually were numerous sales of freight cars older than fifteen years at prices in excess of scrap. CNJ has produced data showing that from 1973 to 1976, some 700 freight cars about thirty years old were sold for reuse. The majority of the cars sold were gondolas, and the prices ranged from $2,100 to $4,600. The GPs have not challenged the accuracy of these data.

Although CNJ's market data indicate that some of its older cars would have been marketable for reuse in 1976, CNJ's appraisal does not take into account the fact that its equipment would have been competing in the market with equipment of other Transferors; for this reason a substantial downward adjustment is necessary.

The first category contains 46 boxcars built between 1956 and 1957. CNJ has introduced evidence of sales for reuse of some 700 older freight cars, but none of those cars sold were boxcars. Solvent railroads would have been especially hesitant to purchase used boxcars or flatcars because during the previous decade the trucking industry had permanently captured much of the traffic formerly carried in cars of that type. The lack of usefulness of this type of car is further evidenced by workpapers contained in CNJ's appendix concerning sales of freight cars. The vast majority of sales cataloged were of gondolas. Only sixteen boxcars were mentioned. Four of these were sold for scrap, and one was sold for only $2500.00. The eleven sold for reuse were not only considerably younger than the boxcars conveyed by CNJ, but had been extensively modified for coil aluminum service. *See* 3 CNJ App. 835-39. The CNJ boxcars should be valued at scrap.

CNJ conveyed 51 gondolas, of which 47 were built in 1957 and four were built in 1965. The GPs do not dispute the marketability of the four newer units. CNJ's contention that there was a reuse market for the older units is buttressed by two important facts. First, CNJ has produced a substantial amount of market data showing sales of used gondolas from 1973 to 1976. In most cases, the units sold were ten years older than CNJ's were in 1976. Second, both the Wyer Dick and DeLeuw Cather studies classified CNJ's gondolas for reuse and assigned them the highest unit value of any car in its fleet ($5,330 and $4,185, respectively).[83] On the basis of these showings, we find that in 1976, CNJ could have sold all of its gondolas at the Wyer Dick price of $5,330 each. This price is consistent with the sales prices reported for gondolas of similar age in the GPs' own workpapers. *See* workpapers USR 92051-00000004-14; 3 CNJ App. 835-39.

CNJ also owned and classified for reuse 131 covered hoppers built in 1957. These hoppers were also classified for reuse by Wyer Dick and DeLeuw Cather, but both of these appraisers assigned them the lowest unit value of any resalable model ($3,453 and $4,433, respectively). CNJ's market data shows that in 1976, 100 twenty-eight year old covered hoppers were sold for $3,095 each. In the light of the applicable market data and the appraisals of Wyer Dick and DeLeuw Cather, we find that eighty-seven, or two thirds, of these units would have been sold for reuse at an average price of $3,453 each.

In the last category are 29 cabooses built in 1942 and valued by CNJ at $4,000 each. These units were 34 years old in 1976, were heated by pot-bellied stoves, were not air-conditioned, and lacked toilet facilities. Not only were they of outdated design, but they would have come on the market at a time when newer, more modern cabooses were readily available. Also, cabooses are normally built to conform to the purchaser's specific work rules, and CNJ's cabooses would not have been suitable to many potential purchasers. CNJ argues that Conrail's conversion program to renovate and standardize conveyed cabooses demonstrates the

value of these units, but the cited testimony does not support CNJ's position. Accordingly, they should be valued as scrap.

C. *Outstanding Equipment Obligations*

There is also dispute between the parties on the matter of outstanding equipment obligations. CNJ claims that these obligations total $1,356,000 while the GPs claim an outstanding balance of $1,624,000. These obligations stem from March 31, 1976 outstanding balances on certain locomotives and freight cars conveyed by CNJ which were subject to Conditional Sales Agreements.

In determining the amount of its outstanding equipment obligations, CNJ utilized the information contained in its own books and records used for the purpose of making its March 31, 1976 R-1 report to the Interstate Commerce Commission. The GPs, on the other hand, utilized a combination of their own hand calculations and computer printouts to calculate this figure, Murphy workpapers, 3 CNJ App. at 996-1011. We find that CNJ's figure is accurate and contains none of the flaws of the GPs' figures. For example, the GPs charge CNJ $35,135 in interest for Conditional Sales Agreements 3 and 4 which both sides agree would have been disaffirmed. Also, while the Conditional Sales Agreements call for level semi-annual payments, the GPs erroneously assumed declining payments for CNJ Sales Agreements 1 and 2. Workpaper USRA 9206500000032 and 00000028, 3 CNJ App. at 1011, 1007. Therefore, we adopt CNJ's figure for Outstanding Equipment Obligations.

D. *Other Machinery and Equipment*

The remaining seven equipment classifications are Roadway Machines, Roadway Small Tools, Shop Machinery, Power Plant Machinery, Passenger Cars, Work Equipment and Miscellaneous Equipment. CNJ values these items at a total amount of

$1,743,000 and the GPs at $649,000. Each of these classifications is discussed below.

1. *Roadway Machines*

The larger items in CNJ's Roadway Machines account include units such as Caterpillar Road Graders, Nordberg Hydrospikers, Kershaw Tie Cranes and Fairmont Rail Lifters, all of which are used by railroads for the purpose of maintaining track and roadbed. This account also includes smaller items such as rail drills, plate placers, tie saws, and rail saws. The GPs' valuation of these roadway machines is $400,000. CNJ values this asset category at $997,000. We find the GPs' valuation the more credible, and we therefore adopt it.

The testimony of Richard Browner, former CNJ Superintendent Work Equipment, was relied on by both sides and is by far the most detailed and persuasive evidence on this account. CNJ asserts that its valuation methodology was "based in large part" on 1974 meetings between Dunn and Browner in which Browner is said to have provided estimates of the market values of CNJ's roadway machinery. Browner's unrebutted testimony, however, is that these discussions did not concern market value, but only "original" cost and in some cases replacement cost. In its reply brief, CNJ failed to present a satisfactory explanation of how it might have reached its determinations of market value.

Moreover, Browner's testimony is not supportive of CNJ's contentions. Browner's testimony reveals not only that CNJ's roadway equipment was put to heavy use and was subject to rapid depreciation, but also that much of it was old and, in some cases, obsolete. Although some of the larger items could be maintained to last as long as 20 years, as CNJ contends, this does not indicate marketability. It is clear that much of CNJ's equipment was rebuilt and kept operational well beyond its expected service life simply because CNJ could not afford to replace it. Even though such equipment was adequate to meet CNJ's continuing needs,

the evidence is persuasive that it would not have been attractive to prospective purchasers in a competitive marketplace.

2. *Roadway Small Tools*

The next account item concerns CNJ's roadway small tools, which CNJ's Dunn valued at $14,000 and the GP's Leseur at $2,000. This account contained such items as shovels, sledge-hammers, pick axes, small power tools, air compressors and table saws for which there is a large ready market both within the railroad industry and without. CNJ's method of valuing these tools was as thorough and conservative as can be expected given the wide variety, scattered locations and relatively low value of the items in this account. CNJ took the $52,000 book value for these items, and trended them using the Bureau of Labor Statistics Indices to obtain estimated 1976 replacement costs. This figure was reduced by 50% to reflect depreciation and condition and then reduced another 90% to reflect the high cost of disposition due to the widely scattered locations of the tools on the railroad and the difficulty of collecting them for sale. CNJ Opening Brief at 449-50; 3 CNJ App. at 556-7, 651.

3. *Shop Machinery*

Evaluating this asset category is particularly difficult as CNJ never maintained shop machinery valuation records in any reliable manner. CNJ valued its shop machinery at $379,000, while the GPs assigned a value of $117,750 to this asset category. Again we adopt CNJ's valuation as we find it conservatively done and inherently credible. This asset category contains forklift trucks, lathes, drill presses, pipe threaders, small tools and other machinery "commonly found in any industrial shop". 3 CNJ App. at 657. Due to the lack of adequate records, CNJ witness Dunn used the 1969 inventories made by Wyer Dick eliminating machines retired in the interim and adding new ones. This list

was then checked against a list prepared by the mechanics department in 1973. After this inventory list was developed, CNJ used the same basic methodology for determining the value of this asset category as it did for Roadway Small Tools. The 1976 replacement costs were reached by trending the indices of the Bureau of Labor Statistics. These figures were then reduced by 75% to reflect possible theft, collection costs, general depreciation and other factors. Machines that were found to be "functionally obsolete or out of service" were deleted from the inventory. 3 CNJ App. at 655. The GPs' lower figures are based on a variety of factors including CNJ's "heavy usage" of the machines, the limited resale value to other railroads and a strong glut effect on the used machinery market. 3 CNJ App. at 934, 964-69. We reject these contentions. There was no evidence that CNJ used these machines more than one eight-hour shift per day. Furthermore, these machines had wide utility outside the railroad industry and therefore any glut effect would have been greatly reduced.

4. *Power Plant Machinery*

Power plant machinery refers to power plant equipment in Elizabeth, New Jersey. The GPs failed to offer a valuation for this account. We therefore adopt the CNJ figure of $4,000. CNJ valued this asset as scrap, assuming no resale value. 3 CNJ App. at 564.

5. *Passenger Train Cars*

CNJ conveyed four passenger train cars. The GPs and CNJ have both placed a total value on these cars of $6,000, which we adopt.

6. *Work Equipment*

The GPs valued CNJ's work equipment at $88,700 and CNJ valued this asset category at $290,000. This difference is largely due to the fact that the GPs classified all of these items (primarily

service cars and locomotive cranes) as scrap. CNJ classified 35 items as scrap for a total value of $59,500 and 21 items for resale at a combined value of $230,500. CNJ persuasively contends that the GPs' valuations of this asset category are placed in doubt by the inconsistencies between its prices for CNJ's work equipment and the prices placed on similar, though older and smaller equipment of other Transferors. CNJ Opening Brief at 457. The GPs valued 28 Diesel Locomotive Cranes of the Erie Lackawanna at $25,000 but classified CNJ's 7 newer and larger capacity cranes as scrap. *See* 3 CNJ App. at 736.

The remaining differences between the two parties are minor except for the valuation of two "air dumps." CNJ assigned a value of $6,000 each to these items. The GPs value these items as scrap but, as a GPs' workpaper, USR 9205100000015; 3 CNJ App. at 840, indicates, the CNJ figure is entirely credible. *See* CNJ Opening Brief at 458. Thus we adopt CNJ's estimate of $290,000 as the value of its work equipment.

7. *Miscellaneous Equipment*

The GPs value CNJ's miscellaneous equipment at $29,700 while CNJ values this equipment at $53,000. This asset category contains 12 trucks and a small amount of truck equipment which the parties agreed was saleable for reuse. While we readily admit that precise, item by item valuations are often not possible for large asset categories consisting of many disparate items, in this instance there was no reason for the GPs to lump together these few items into three categories ("Automobiles and Trucks," "Special Equipped Trucks" and "Hi Rail Equipment"). CNJ's analysis, which was done item by item, is inherently more credible and we adopt it. *See* 3 CNJ App. at 672. CNJ witness Dunn estimated resale values ranging from $400 each for CNJ's three 1968 Dodge vans to $15,000 each for two 1974 radio-equipped Ford dump trucks which cost $20,000 each in 1974.

We, therefore, find the liquidation value of CNJ's equipment, after deduction for related obligations, to be $6,053,041. The details are set forth in the following tables:

Locomotives

Description	*Year Built*	*No. of Units*	*Unit*	*Total*
EMD Switcher SW1	1939-42	4	9,100	36,400
EMD Switcher NW2	1942	2	9,100	18,200
EMD Switcher SW7	1950	4	9,100	36,400
EMD Switcher SW9	1951-52	11	22,000	242,000
EMD Road Switcher GP7, 7P	1952	11	5 × 30,000 6 × 9,100	150,000 54,600
ALCO Road Switcher RS2	1950	8	9,100	72,800
ALCO Road Switcher RS3	1951-53	18	9,100	163,800
EMD Road Freight SD35	1965	12	182,000	2,184,000
EMD Road Freight SD40	1967	8	246,375	1,971,000
		78		4,929,200

Freight Cars & Cabooses

Description	*Year Built*	*No. of Units*	*Unit*	*Total*
Box Cars	1957	34	1,200	40,800
Equipped Box Cars	1956-57	12	1,200	14,400
Gondolas	1957-65	51	51 × 5,330	271,830
Covered Hoppers	1956-57	131	87 × 3,453	300,411
			44 × 1,400	61,600
Cabooses	1942	29	1,100	31,900
		257		720,941
Scrap value of remaining cars		496		612,900
		793		1,333,841

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Other Equipment Accounts

Description	
Roadway Sm. Tools	14,000
Roadway Machinery	400,000
Shop Machinery	379,000
Power Plant Machinery	4,000
Passenger Cars	6,000
Work Equipment	290,000
Misc. Equipment	53,000
	1,146,000

Summary

Locomotives	4,929,200
Freight Cars and Cabooses	1,333,841
Other Equipment Accounts	1,146,000
	7,409,041
Equipment Obligations	1,356,000
	6,053,041

VI.

DEDUCTIONS FROM VALUE OF FACILITIES AND EQUIPMENT

A. *Winddown Costs*

Winddown is described by the GPs as

> a discrete phase of activity that any operating railroad seeking to withdraw completely from the rail business would have to go through. During winddown the transferors would have issued embargoes or cancelled tariffs, completed the handling of the remaining freight traffic they were required or chose to accept, terminated passenger operations, and begun the processes of clearing their lines of foreign cars and assembling their own rolling stock for sale after it was no longer needed for rail service. At

> the same time, they would have accelerated preparations to dispose of assets—collecting, inspecting, and inventorying equipment, materials and supplies, advertising and pursuing contacts with potential buyers—and would have made sales whenever possible. GPs Opening Brief at O-3.

The GPs contend that CNJ would have had to begin winddown on April 1, 1976, when permission to abandon rail service would have been received. Notices could then be sent out informing the public that all freight and passenger service would cease within a few weeks. Revenues would decline sharply during winddown, but operating costs could not be reduced in proportion to this fall. According to the GPs' consultant L. Michael Kenny, net operating losses could be minimized by conducting winddown in as brief a period as possible, with one month the minimum time in which an operation of CNJ's size could be halted. The GPs calculate that if CNJ had received permission to abandon effective on April 1, 1976, it would have incurred net operating losses of $744,803 during that month, of which $703,583 would be allocable to the conveyed assets. This amount, the GPs contend, should be deducted from the total liquidation value of the conveyed assets to arrive at net *realizable* liquidation value.

CNJ responds that no such expense would have been incurred after April 1, 1976 since all rail services would have ceased by that time. Winddown activities could have been conducted in prior months, particularly during the months immediately preceding April 1, 1976 with employees planning and preparing for a shutdown on that date while freight and passenger service continued in a diminishing degree.

In other words, the GPs assume a railroad operation running full tilt on March 31, 1976, with all aspects of the winddown remaining to be done after that date, whereas CNJ assumes a "dead railroad" on April 1, 1976, with the winddown already completed. The GPs appear to base their argument for a post-April 1, 1976 winddown on the assumption that CNJ could not

have known precisely when the ICC would permit abandonment and would have had to operate normally until the permission to abandon was obtained. CNJ, on the other hand, contends that it would have known long prior to April 1, 1976 that its abandonment could commence on or about that date.

As we have stated elsewhere with respect to sales of real estate, we consider CNJ's assumption to be the more plausible. In the *Rail Use Opinion,* we found that in the alternative scenario all "proposed sales and abandonments probably would have been completed on, but not before, April 1, 1976." 531 F. Supp. at 1294. Congress would likely have established some such date as the deadline for ICC action on all conveyances and abandonments. *Id.* at 1304. Hence CNJ is correct in supposing that the abandonment date would have been known in advance. We conclude that under the alternative scenario rail operations would not have continued on CNJ's conveyed properties for any significant period after April 1, 1976, and thus that the net operating losses due to winddown after that date would not have been substantial.

It may be true, on the other hand, that execution of a winddown program prior to April 1, 1976, would have augmented CNJ's losses for that period, despite CNJ's contention that the final weeks would have witnessed a surge of traffic which shippers would have wished to move while rail service remained available. But there are several reasons why we cannot translate such increased losses into an expense deductible from the otherwise realizable value of the conveyed properties. One is that the GPs, preferring to stake all on their position that the winddown would not have begun until April 1, 1976, have proffered no evidence of the extent to which losses prior to April 1, 1976 would have been augmented if CNJ had chosen to accomplish the winddown, in whole or in large part, before that date. Another is CNJ's claim that augmented losses prior to April 1, 1976, if any, would have been offset at least in part by federal interim assistance. *See Rail Use Opinion,* 531 F. Supp. at 1299. The GPs counter that federal subsidies would have been offered only to Transferors committed

to preserving rail service on their lines and that once CNJ's hypothetical resolve to abandon rail service was known, interim financial aid would have been cut off entirely. While there is some conceptual plausibility in this argument, we are not so sure that Congress would have made this distinction rather than provide a subsidy for all affected carriers[84] until any hope of continued rail service was lost. Finally, increased losses in the period prior to April 1, 1976 are not properly viewed as an expense which CNJ would have incurred in disposing of the property taken from it on that date. They would have resulted rather in a depletion of the current assets retained by the CNJ Trustee. CNJ could argue that such a depletion, if not reimbursed, might have qualified as a claim for compensable unconstitutional erosion, *see CUE Opinion,* 439 F. Supp. at 1356—against which the GPs might argue that, to the extent that the Rail Act relieved CNJ of such expenses by providing for continued rail service after April 1, 1976, this would constitute an element of "value of other benefits", *see CMV Opinion,* 445 F. Supp. at 1042-43, a subject which we have deferred for subsequent consideration if that should become necessary. It is greatly to be hoped that, as was the case with the many settlements we have approved, the parties can agree that CUE and VOB cancel each other out. In any event, arguments as to the effect of a hypothetical winddown prior to April 1, 1976 are not appropriate for consideration here.

The GPs' winddown deduction will therefore not be allowed.

B. *Liquidation Organization and Disposition Costs*

The GPs insist that, in order to calculate the net realizable value of CNJ's conveyed assets, a deduction must be made for all the expenses required to sell the assets. In other portions of this opinion we adopt the GPs' general position with respect to the costs of holding and selling CNJ's conveyed real estate. We have reduced the amount of the claimed deduction, and have considered and rejected, on the facts of this case, the GPs' proposal for a deduction of $703,583 for "winddown" expenses. We deal here

with the GPs' proposed deductions for the costs of collecting, sorting, and safeguarding the conveyed facilities and equipment prior to sale, making emergency repairs, and negotiating sales of these assets. We also consider their contention that other costs of liquidating CNJ's total operation, such as settling interline accounts, closing out accounts receivable and payable, adjusting claims, and all other legal, accounting and management tasks involved in a liquidation, should be deducted.

CNJ contests the propriety of making any deduction from the sale price of its assets for the expenses of disposition and liquidation. The bases for this are (1) that its conveyed properties were not in fact dismantled and sold in a nonrail use liquidation, and (2) that they would not have been dismantled in the absence of the Rail Act since New Jersey would have bought them for continued rail use. The former argument requires little discussion since the question in any condemnation valuation is what the properties would have realized in the absence of condemnation. The latter argument is readily answered once CNJ's perception theory is rejected. New Jersey would have paid, or been required to pay in condemnation, only what CNJ could have obtained by liquidation. We proceed therefore to CNJ's alternative argument, in which we find considerable merit, namely, that the GPs' estimate of $5,434,794 for the deductions here under consideration is far too high.

It is unfortunate that the GPs did not develop independent estimates for the disposition and liquidation costs here considered, as they did for the asset values themselves, but relied instead on the study commissioned by CNJ's former Trustee from transportation consultants Wyer, Dick & Co. to value the railroad and its affiliated lines as of June 30, 1968. This study estimated the liquidation value of non-real estate assets at $40,067,500 and related liquidation expenses at $3,243,600[85] (approximately 8.1% of liquidation value). Russell F. Murphy, a transportation consultant and former financial officer of USRA, testified for the GPs that he adjusted Wyer Dick's liquidation expense figure for

inflation, the decrease in CNJ's size between 1968 and 1976, and possible double-counting, then allocated the resulting figure between CNJ's conveyed and retained properties, and discounted to present value as of April 1, 1976. Murphy's result, $5,434,794 in facilities and equipment disposition and liquidation costs, was approximately 32% of the GPs' estimated facilities and equipment liquidation value of $16,758,000. This fourfold increase in the ratio of disposition and general liquidation expenses to total non-real estate assets being valued[86] prompted CNJ to offer the testimony of Charles J. Meyer, now president of Wyer, Dick & Co. and principal author of the 1968 study, criticizing Murphy's adjustments at nearly every point. We here scrutinize Murphy's work for the flaws Meyer suggests, but do not subscribe to Meyer's and CNJ's broader conclusion that the potential flaws in Murphy's analysis make realistic adjustment of Wyer Dick's 1968 study impossible.[87]

1. *Adjustment for Inflation*

Murphy took as his starting point Wyer Dick's estimate of $3,803,050[88] in liquidation expenses for CNJ and nine small affiliated lines. These expenses were largely attributable to labor costs, and most of the remainder, for supplies, space, and fringe benefits, had been computed as a percentage of labor costs. Murphy adjusted this figure upward for inflation between June 30, 1968, and April 1, 1976, calculating item by item on the basis of cost indices for railroads in the eastern United States. Murphy's result was $7,467,612, an increase of 96.4% over the 1968 figure.

CNJ disputes the increase first on the ground that whatever the other railroads were doing, CNJ substantially delayed wage increases beginning in 1971 and would have frozen wages altogether in the alternative scenario, and therefore should not be held to an industry-wide inflation index that showed wages rising 98% between 1968 and 1976. CNJ refrained from submitting evidence, presumably readily available to it, showing what wages the employees who would have been engaged in liquidation were

actually receiving on April 1, 1976, and thereafter. The GPs, on the other hand, submitted an exhibit showing that CNJ had incurred wage increases of 53% between January 1971 and March 1974, 39 GPs Supp. App. at 188. We thus have no sufficient basis for scaling down Murphy's inflation adjustment by any determinable amount for the reason here considered.

CNJ's other argument against Murphy's inflation adjustment is that while Murphy assumed that nonproffered lines of the other Transferors would be disposed of for nonrail use, he made no study of the number of railroad laborers left unemployed by such dispositions and concluded that CNJ's labor costs over the disposition period would not be affected by any ensuing "labor glut". This contention, while rather amusing as an effort by CNJ to hoist the GPs by one of their own petards, is not persuasive. The "labor glut" would not occur until April 1, 1976, and Murphy made no upward adjustments for inflation after that date. Any "glut" in the labor market thereafter might have slowed the rate of further inflationary increase, but would hardly have driven wages below the April 1, 1976 levels applied by the GPs throughout the disposition period. Finding no error in the GPs' inflation analysis within our ability to correct from the evidence, we accept Murphy's adjustment of Wyer Dick's figure upward to $7,467,612 to account for inflation from June 30, 1968, to April 1, 1976.

2. *Adjustment for Reduction in Size of CNJ by 1976*

Murphy next considered the decrease in CNJ's property and assets from 1968 to 1976. From mid-1968 to March 1976, CNJ curtailed its operations substantially (ceasing all operations in Pennsylvania), eliminated its affiliated lines, reduced its payroll from 3,536 employees to 1,779, and disposed of 67% of its rolling stock. Its real estate and amount of track showed less of a decline, from 481 road miles (for CNJ and affiliated lines) in 1968 to 327 in 1976, and from 1,108 track miles in 1968 to 680 in 1976.

Murphy made no reduction in the $7,467,612 disposition and liquidation expense figure for this decrease. It was his conclusion that Wyer, Dick & Co. "significantly understated" the costs of liquidating the larger CNJ system in 1968 and that the staffing of executive, legal, accounting, transportation, engineering, mechanical, purchasing, security, labor relations, and claims departments in the 1968 study was barely adequate to "carry out an orderly and efficient liquidation" of a railroad of CNJ's reduced size in April 1976, Murphy Testimony, February 16, 1982 at 20. It seems unfortunate that upon making this judgment Murphy did not begin afresh; certainly his approach of using the Wyer Dick study where it suited and rejecting it where it did not calls for careful scrutiny on our part.

Murphy's "best example" of inadequate staffing in the Wyer Dick study was the maintenance-of-equipment staff of five (three superintendents and two clerks) for the first six months of disposition, with one superintendent and one clerk remaining in the second year. He doubted that so small a staff would be adequate to sell off the locomotives and other rolling stock CNJ conveyed in 1976, given the repair functions he expected they would have to perform. However, as CNJ's witness Meyer demonstrated and the GPs have conceded, Murphy was in error when he supposed that this staff would have had repair duties. The Wyer Dick study made it quite clear that the costs of this mechanical department staff did "not include estimated equipment repair costs", which were included elsewhere in the study. The staff envisioned in Wyer Dick's study would have adequately handled the maintenance-of-equipment crew's remaining duty, the sale of locomotives and freight cars for reuse, and the Purchasing & Stores staff would have assisted in sales for scrap value.

Murphy's other examples of inadequate staffing are Wyer Dick's inclusion of a single train crew for gathering loaded cars from and returning empty cars to the dismantlement work trains and the inclusion of a maintenance-of-way staff of six to handle wreck-train service and emergency track maintenance. Again

Meyer pointed out that Wyer Dick made ample provision for these functions in the form of a dismantlement force consisting of four work train gangs (revealed in Wyer Dick's workpapers to amount to 116 persons).

We find no specific support, therefore, for Murphy's conclusion that "excessively" tight staffing throughout Wyer Dick's study made its personnel tables appropriate for liquidating a much smaller CNJ in 1976. On the other hand, we recognize that a railroad cannot employ fractions of persons or expect to find individuals with expertise spanning several departments. According to the summary of Wyer Dick workpapers in Appendix 4A, pp. 4A-21 to 4A-24 of Murphy's testimony, most staff functions were to be performed by single individuals for varying lengths of time. Still, with a 67% reduction in rolling stock and a 39% reduction in track miles, a 40% reduction in personnel and a proportionate reduction in other expenses would seem reasonable. We thus carry to the next round of adjustments in Murphy's testimony the reduced liquidation cost estimate of $4,480,567.

3. *Adjustment for Division Between Conveyed and Retained Properties*

Murphy's sequence of adjustments would next have us subtract those costs that would otherwise be "double-counted" because of inclusion elsewhere in the parties' Stipulation Regarding the Cost of Dismantlement and Transportation for Conveyed Trackwork dated December 11, 1981, and the GPs' proofs. Because all the costs addressed elsewhere in the stipulation for track dismantlement, real estate selling costs, and so forth are confined to CNJ's conveyed assets, and the figure of $4,480,567 has not yet been allocated between conveyed and retained assets, to subtract for double-counting at this point would be a clear error in computation. We therefore proceed directly to the allocation between conveyed and retained assets. We begin by noting that Murphy based his allocation of total liquidation costs solely on the proportions of track (92.1%, by track mile), rolling stock (100%), and

real estate (78.6%, by acre) conveyed by CNJ. This resulted in an overall attribution of 85.6% of the liquidation costs to conveyed properties.[89]

Meyer testified on behalf of CNJ that the Wyer Dick study included many other categories of assets, all of which were retained by CNJ after April 1, 1976. Management of liquid assets, collection of accounts receivable, and liquidation of CNJ's investments in its affiliated lines are among functions left out of an allocation formula which focuses solely on proportions of real estate, rolling stock, and track. To the extent, therefore, that liquidation costs are attributable to these assets, Murphy's methodology misallocated them. We agree that a different allocation is necessary and conclude that the record permits the following division of Wyer Dick's valuation estimates between "conveyed" and "retained" asset types:

	1968 Value	*"Retained"*	*"Conveyed"*
Current Assets	12,371,200		
Materials & Supplies			2,018,200
Other Current Assets		10,353,000	
Special Funds	1,037,500	1,037,500	
Investments	9,187,600	9,187,600	
Properties			
Real Estate (78.6.%)	56,255,500	12,038,667	44,216,823
Rolling Stock (100%)	6,747,800		6,747,800
Track, Etc. (92.1%)	7,749,700	612,226	7,137,474
Other Assets & Charges	2,972,700	2,972,700	
TOTAL	96,321,990	36,201,693	60,120,297
(Percentage)		(37.6%)	(62.4%)

By this calculation, 62.4% of gross liquidation value was accounted for in Wyer Dick's study by asset and property categories corresponding to those conveyed in 1976, rather than the 85.6% estimated by Murphy using divisions of real estate, rolling stock and track alone. It is true that some of Wyer Dick's disposition and liquidation costs, such as mechanical and engineering

staffs, would be tied more or less completely to the facilities and equipment assets, while other costs, such as those for legal work (at $2,068,900, after adjustment for inflation, the largest single item in the study), accounting staff, and top management, are shared more evenly between these and the various asset categories wholly retained by CNJ, or even, as CNJ argues, are tilted more heavily toward the latter. Considering the breakdown of asset values and of liquidation expenses, we find that an allocation of 62.4% of total expenses to CNJ's properties and assets conveyed on April 1, 1976, is proper on the basis of the evidence. We therefore carry forward $2,795,874 to the next stage of adjustment.

4. *Adjustment for Double-Counting*

We take up now the elimination of those costs of disposition and liquidation already accounted for in the stipulations and proofs submitted by the parties, as well as other corrections proposed by the parties in arriving at a proper estimate of liquidation expenses for the conveyed properties. Murphy deducted $243,655 attributable to real estate disposition costs already calculated by Tesh, $163,354 duplicative of the GPs' winddown estimate, $254,606 in transportation and train costs post-dating the end of the stipulated dismantlement period, and the whole of the expense allocated to the Trustee's Office, $1,030,561. When the last of these figures is reduced to the portion attributable to conveyed properties, a total of $1,304,685 would be subtracted from the figure carried forward, which would leave $1,491,189 in liquidation expenses net of double-counting. However, our disallowance of winddown expenses requires that Murphy's deduction of $163,354 for double-counting expenses of clerical forces and train costs required to return freight cars of other railroads at the end of winddown must be restored, making our running total $1,654,543.

CNJ, of course, does not take issue with these subtractions, but does contest Murphy's two further "corrections" adding

$1,885,077 for management costs after the fifth year of liquidation activity and $333,705 for an increased security staff to deter pilferage and vandalism in the first year. As to the former, the expenses would relate solely to sale of remaining real estate, and have been rejected in another portion of this opinion. Any coordination of the few remaining in-house real estate sales personnel could have been handled by the Trustee's Office, for which the GPs correctly made no deduction. With respect to the latter correction, CNJ argues that an increase in security staff over that provided in Wyer Dick's study would not be warranted, especially in the light of the decrease in CNJ's assets between 1968 and 1976. Despite this we believe some increase in Wyer Dick's figure was warranted and allow an added $175,000 for security costs. Our figure for liquidation expenses is increased, therefore, to $1,829,543.

CNJ contends further that many expenses arguably covered by the Trackwork Dismantlement Stipulation are duplicated in expenses included in the Wyer Dick study and Murphy's security cost correction. The Stipulation, however, while providing for $5,400,000 in trackwork dismantlement and transportation costs, states in paragraph 4 that it does not cover the costs of:

> An engineering group to oversee the entire dismantlement process; a transportation group; maintenance of equipment group; personnel and payroll group; financial and accounting support; legal and management services; security forces; sales forces and expenses (other than freight); clerical forces above the field dismantlement level; taxes (other than payroll taxes for field dismantlement personnel), or the separate activities necessary for the winddown of rail operations.

In response, CNJ points to paragraph 7 of the Stipulation:

> The parties agree that the stipulated cost of dismantlement and transportation would have been the amount stated [$5,400,000] regardless of the composition,

> number, kind or *employer* of work crews that would or might reasonably and feasibly have been used to dismantle trackwork. [Emphasis supplied.]

CNJ argues on the basis of paragraph 7 that the Stipulation contemplates a dismantlement by a contractor who purchases the trackwork in place and absorbs all supervision, management and clerical costs. This interpretation would fly in the face of paragraph 4, rendering all its exclusions meaningless, and would moreover require recalculation of the sale value of track material in order to compensate the contractor for his additional costs and risks. We reject CNJ's contentions of double-counting based on the Trackwork Dismantlement Stipulation.

Through Meyer's testimony CNJ made two larger points that can be treated as variations on the double-counting argument. The first is that the liquidation value of CNJ's conveyed properties should not be decreased by costs duplicating those CNJ has already incurred in the real world to wind up its rail operations on the retained properties. CNJ asserts that it has settled interline accounts, collected its receivables and paid its payables, adjusted claims against it, managed its liquid assets, and maintained its books and records at its own expense while undergoing reorganization. Although CNJ has not provided an estimate of these expenses, it contends that they duplicate most of the legal, accounting, and managerial functions assigned in the Wyer Dick study. At bottom, this argument on CNJ's part is that the costs of winding up corporate affairs and going out of business, as opposed to the direct costs of collecting and selling off the conveyed assets and properties, should be allocated wholly to the retained properties because in fact CNJ accomplished all these tasks on its own. Our allocation of only 62.4% of the total estimated costs of liquidation to the conveyed assets takes sufficient account of CNJ's argument. CNJ could not have escaped substantial additional legal, managerial, and accounting expenses

in selling its conveyed assets in a nonrail use liquidation of the entire railroad.

CNJ's second broad double-counting argument is that the expenses it actually incurred in conveying its properties to Conrail, including the expenses of litigating this action, should offset any deduction for disposition costs and liquidation expenses. Such items are not appropriate for consideration in determining what CNJ could have obtained by sale of the conveyed properties for nonrail use. As the Supreme Court has said, "[a]ttorneys' fees and expenses are not embraced within just compensation for land taken by eminent domain", *Dohany* v. *Rogers*, 281 U.S. 362, 368 (1930); *United States* v. *Bodcaw Co.*, 440 U.S. 202 (1979).

5. *Adjustment to Present Value*

Murphy's final adjustment, one welcomed by CNJ, is the reduction of the liquidation organization and disposition costs to their present value on April 1, 1976. Applying the stipulated discount rate of 9.13% to the figure of $1,829,543 at which we have arrived, and adopting the percentage allocations through the fifth year of disposition as estimated by Murphy in Appendix 10 of his testimony, table 10-8, we reach a figure of $1,683,592.

VII.

LEHIGH & NEW ENGLAND RAILWAY CO.

A. *Introduction*

The Lehigh & New England Railway Co. (L&NE) was operated for many years as part of the CNJ rail system. Jack D. Storm, in testimony submitted on behalf of L&NE, stated that his estimate of the net liquidation value of its conveyed properties was based on the same methodology employed in valuing the CNJ. Moreover, L&NE's seven-page brief "adopts those portions of the CNJ brief analyzing the Government Parties' evidence with respect to facilities and equipment", L&NE Brief at 4,

and "the analysis and conclusions reached by the CNJ" with respect to deductions from real estate base values for title defects and selling expenses. *Id.* at 6-7. Our task in resolving the difference between the GPs' valuation of L&NE's conveyed property, $927,000, and L&NE's own valuation of $3,459,000, is lightened by L&NE's nearly complete reliance on contentions of CNJ discussed in prior sections of this opinion.

B. *Real Estate*

1. *Base Value*

L&NE conveyed 433.9 acres of real estate, over 90% of which the GPs' appraisers characterized as "abutter" property marketable only to adjoining landowners. L&NE and the GPs have stipulated that the base value of this conveyed real estate is $642,198. Sp. Ct. Rptr. N-38960. The stipulation, however, expressly provides that the state of L&NE's title to the property is not considered, and that the figure represents the sum of individual parcel appraisals without discounting. The parties also agree that the stipulated base value takes no account of holding or selling expenses. L&NE adopts CNJ's position that no deduction for title defects or discounting should be made, and takes a 12.5% deduction for all costs of disposition.

2. *Adjustments to Base Value*

(a) *Title Defects.* The GPs' largest deduction from the stipulated real estate base value is 44.531% for title defects. As we held in Section III.B.1, *supra,* some deduction for lack of title or the cost of curing title is necessary. However, the magnitude of the reduction in L&NE's case requires further scrutiny. Lacouture, the GPs' expert witness on title defects, examined 72.4% of L&NE's valuation maps to arrive at the 44.531% figure, making L&NE's title problems by far the worst of the five Transferors he considered.[90] The comparable reduction for CNJ's title defects was 7.187%. Lacouture explained the wide variation in title

defect reductions as the result of two factors. First, L&NE's conveyed property included only rights of way assembled in the nineteenth century with whatever limited interests the railroad could then acquire, and no "major properties" such as CNJ's Elizabethport Yard, which was constructed later with more attention to the need for obtaining good title. Second, Lacouture found a correlation between lower per-acre value of properties and greater numbers of title defects. L&NE's conveyed real estate was substantially lower in value, at somewhat under $1500 per acre, than CNJ's, which came to more than $8300 per acre even by the GPs' appraisal. Additionally, L&NE's conveyed real estate consisted of rights of way along two branch lines likely to have been assembled around the same time with consistent inattention to the quality of title obtained, while CNJ's much larger conveyed property would be expected to show greater variation in quality of title. L&NE made no specific answer to these arguments. We conclude that Lacouture has satisfactorily explained L&NE's substantially larger reduction for title defects, and accordingly deduct 44.531% from the stipulated base value, leaving $356,221.[91]

(b) *Selling Costs.* We concluded in Section III.B.2, that the total deduction for CNJ's selling costs should be 11% of real estate base value. Storm testified on behalf of L&NE that 12.5% was deducted for the costs of disposition. L&NE's slightly higher figure is warranted because the per-acre value that could be realized from L&NE's conveyed property is lower. We noted in connection with CNJ's selling costs that higher sales commissions are incurred with respect to less expensive properties. Accordingly, 12.5% is deducted from the remaining base value of L&NE's real estate, leaving a net figure of $311,693.

(c) *Discount to Present Value.* As our discussion in Section III.B.3 indicates, discounting is appropriate where the taking is of many parcels requiring several years to sell. We recognize, however, that sale of L&NE's 433.9 conveyed acres along two branch lines would be a much less complicated task than sale of CNJ's

more than 3000 conveyed acres. We conclude that L&NE's real estate could all have been sold in a sufficiently short period to make unnecessary discounting of the proceeds or deduction for holding costs less appreciation.

C. *Facilities and Other Assets*

Amounts of ties, rail, turnouts, other track material, and ballast along L&NE's 62.8 miles of track were stipulated by the parties. Sp. Ct. Rptr. N-37177 to N-37186. In acordance with the principles adduced in Part IV of this opinion, we assign value to these assets as follows:

1. *Ballast*

On behalf of L&NE, Storm calculated that the stipulated 140,510 cubic yards of ballast on L&NE's tracks could be sold at $1 per cubic yard, with costs of removal and sale totalling more than 50%, for an effective recovery of $70,000. The GPs ascribed no value to the ballast on conveyed property of CNJ and L&NE. For the reasons stated in Section IV.A, we conclude that the ballast had no value.

2. *Ties in Track*

Storm valued the stipulated 188,400 ties in L&NE's track at $496,000. The GPs contended that L&NE's ties were worthless. Although Storm's estimate of the number of ties reusable for rail purposes and for landscape purposes was more conservative than that employed in his valuation of CNJ's ties, we find it necessary to apply our conclusions in Section IV.B, *supra*. Adopting the estimate of 406 reusable ties per mile derived from the testimony of Mewhinney, we arrive at 16,768 ties along L&NE's 41.3 miles of main and branch track suitable for rail reuse. Applying Rodola's conclusions from his 1978 valuation, we value these ties at $2.50 each for a total of $41,920. We also take Rodola's estimate of 10% of the remaining ties, or 17,163, as a reasonable

number for landscape use. At $2 each, the landscape ties could have been sold for a total of $34,326. The combined value of L&NE's ties is therefore $76,246.

3. *Rail and OTM*

The amounts of L&NE's rail and OTM of varying weights have been stipulated, and the valuations range from L&NE's $2,070,000 to the GPs' $871,000. We reiterate our conclusion in Section IV.C, *supra,* that rail weighing 130 lbs. or more could be sold for reuse, and adopt Storm's categorization of the proportions of 130-lbs. and 140-lbs. rail suitable for reuse and for scrap. As we noted in Section IV.C, *supra,* testimony established a limited reuse demand for rail weighing 110 to 115 lbs. Although CNJ conveyed no rail in that category, L&NE conveyed some 3,130 tons of 112-lbs. and 115-lbs. rail. Of the L&NE rail of this intermediate weight categorized by Storm as suitable for reuse, we determine that half could have been marketed for reuse and the rest would have been sold for scrap. Of L&NE's rail lighter than 110 lbs., all should be valued at scrap prices. We further apply the price of $207.50 per ton for reusable rail and the prices determined by CNJ for scrap. There is little difference between L&NE's estimate of $531,000 in track dismantlement costs and the GPs' estimate of $528,000. We adopt L&NE's figure. As we found in Section IV.C, *supra,* turnouts and OTM should be valued along with the rail they accompany.

4. *Other Materials and Supplies*

Storm's $21,000 valuation of L&NE's inventory of replacement parts, rail, OTM and ties is not supported by evidence in the record and cannot be adopted. It was based on a letter received by Storm from L&NE's Trustee stating that a computer listing showed L&NE's physical inventory of materials and supplies as of March 31, 1976 at $34,893.39. Storm never received the computerized inventory from L&NE, but instead merely rounded

this figure to $35,000 and applied a 40% across-the-board reduction to reach his $21,000 estimate. This showing fails to meet the requirement of "particularity" in the Sixth Pretrial Order. The GPs are correct, therefore, in assigning no value to L&NE's other material and supplies.

5. *Miscellaneous Assets*

L&NE's Trustee communicated to Storm an estimate of $2,000 for office equipment, furniture, and appurtenances, again with no effort at particularity. We adopt the GPs' contention that these assets should be given no value. Storm ascribed a "nominal value" of $1,000 to L&NE's communications facilities, while the GPs offered a more careful calculation of reuse, scrap, and dismantlement estimates to arrive at $660. We adopt the latter figure.

D. *Equipment*

1. *Locomotives*

L&NE conveyed two locomotives, both GP-7 road switchers built in 1952 and rebuilt in 1959 after they fell into New York Harbor. These locomotives are identified in a stipulation between the parties, Sp. Ct. Rptr. N-18110 to N-18113. L&NE values the locomotives together at $200,000 for reuse, while the GPs assign a scrap value of $17,000 for the pair. We determined in Section V.A, *supra,* that of the eleven CNJ switchers of the same vintage and model, six would have been sold for scrap and five would have been sold for reuse at $30,000 each. We conclude that L&NE's two locomotives, because of their refitting in 1959, could also have been sold for reuse, thus making their total value $60,000.

2. *Cabooses*

L&NE conveyed four cabooses, all built in 1937, and no other rolling stock. Sp. Ct. Rptr. N-37165 to N-37168. Storm valued

the cabooses at $4,000 each, a price at which he thought hobbyists, hunters, and fishermen might purchase them. We conclude that the GPs are correct in assigning L&NE's cabooses a scrap value of $1,000 each, for a total of $4,000.

3. *Roadway Small Tools, etc.*

L&NE valued its Roadway Machines inventory, consisting of a tamper and a welder, Sp. Ct. Rptr. N-37169 to N-37172, at $7,000; its Roadway Small Tools inventory at $2,000; its Work Equipment at $7,000; and its Miscellaneous Equipment, consisting of two 1974 trucks, Sp. Ct. Rptr. N-37173 to N-37176, at $10,000. The GPs determined that no value should be given to Roadway Small Tools or Work Equipment, but that a combined $600 would compensate L&NE for its Roadway Machines and Miscellaneous Equipment. We find it implausible that L&NE's items of roadway machinery and trucks would be worth a mere $150 each and its other equipment categories not worth the effort of collection, sorting, and sale. We therefore accept L&NE's values for these asset categories.

E. *Winddown and Liquidation Organization and Disposition Costs*

Murphy, testifying for the GPs, estimated that the costs of winding down operations and liquidating the conveyed portions of L&NE along with CNJ would have amounted to an incremental deduction of $85,000 over and above the costs of liquidating CNJ alone. He testified that liquidation of L&NE as an independent entity would have been much more expensive. Murphy stated in deposition that $15,000 of the $85,000 total would have been attributable to L&NE's winddown. In the light of our conclusion in Section VI.A, *supra,* that no deduction for winddown is warranted, this amount is subtracted from Murphy's estimate, leaving $70,000 as our estimate of the costs of liquidating and disposing of L&NE's conveyed facilities and equipment.

VIII.

CONCLUSION

Petitions for reconsideration may be served and filed on or before 21 days from the filing of this opinion. Such petitions shall be limited to instances where the court is thought to have misapprehended evidence or to have erred in computations and shall not repeat arguments that have been made at length in the opening briefs and reply briefs and in oral argument and have been fully considered, *see* 531 F. Supp. at 1383. Such petitions shall be based solely on the record and shall not contain proffers of new evidence. Answers to such petitions shall be filed within 14 days.

We direct the parties, within 21 days from the filing of our ruling on any petitions for reconsideration (or, in the event that no such petitions are filed, within 35 days from the filing of this opinion), to submit an agreed judgment fixing the net liquidation value of the properties conveyed by CNJ in accordance with this opinion (and any opinion on the petitions for reconsideration) or if the parties are unable to agree, separate proposed judgments together with memoranda explaining the points of difference. The court considers the rulings in this opinion to be sufficiently definite and the amounts open to argument to be sufficiently small that the parties should be able to submit a single agreed judgment. Submission of the proposed judgment or judgments here directed will, of course, be without prejudice to the rights of the parties to review of our rulings by the Supreme Court of the United States. At the time when such judgment or judgments are submitted, the parties shall also indicate whether they agree that the court may take the net liquidation value as the base value of each certificate of value under § 306(a)(4) of the Act or whether either side desires to litigate the issues of the value of

other benefits and compensable unconstitutional erosion as provided in §§ 306(a)(4)(B) and (C). This opinion shall not constitute a "finding or determination" within § 303(d) of the Rail Act until final judgment is entered.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL O. THOMSEN

Roszel O. Thomsen
Judge

Appendix J

FOOTNOTES

1. CNJ owns 49.9% of the preferred stock and 100% of the common stock of the Raritan River R.R. Under the Amended Certificate of Incorporation, CNJ is entitled to 49.9% of the first $1,981,600 of the value of the Raritan River, and any amounts in excess of that figure.

2. L&NE was operated for a number of years as part of the CNJ system. It has relied virtually exclusively on CNJ's arguments in the instant litigation.

3. The location of these lines is described at 531 F. Supp. at 1209 and 1373-74.

4. According to CNJ, the tentative offer was for all of CNJ's properties except three parcels of off-line realty and certain court-controlled accounts. Under the terms of the offer, the State was allegedly to assume $94 million in obligations and pay $25 million in cash. 531 F. Supp. at 1376. CNJ translated this into a promise to pay about $100 million for the conveyed properties.

5. *Sharp* v. *United States,* 191 U.S. 341, 348-49 (1903); *United States* v. *Smith,* 355 F.2d 807, 811 (5th Cir. 1966); *Liflans Corp.* v. *United States,* 390 F.2d 965, 969-70 (Ct. Cl. 1968); *Missouri Baptist Hosp.* v. *United States,* 555 F.2d 290, 302-03 (Ct. Cl. 1977); *United States ex. rel. TVA* v. *72.0 Acres of Land,* 425 F. Supp. 929, 938 n.3 (E.D. Tenn. 1976); *but see Wolff* v. *Commonwealth of Puerto Rico,* 341 F.2d 945, 947 (1st Cir. 1965).

6. The Peabody study assessed CNJ's book value at $109,439,000, CNJ's reproduction value (reproduction cost less depreciation) at $676,359,000 and CNJ's going concern value at $141,683,000.

7. After reaching a determination of the State's 1974 perception of the scrap value of the assets which CNJ conveyed on April 1, 1976, CNJ sought to add still other items. CNJ contends that under its perception approach, it is entitled to receive payment for the additional costs incurred and for the value of lost benefits foregone between late 1974 and April 1, 1976. CNJ puts these costs and lost benefits at $22,500,000—$14 million for the removal of the Newark Bay Bridge; $7.5 million in interest accruals; and $1 million for loss of investment income. CNJ also argues that it is reasonable to expect that the 1974 agreement between the State and CNJ would have provided for a 6% annual escalation in the purchase price of $72,886,000 reached in the hypothetical 1974 agreement. Such an escalation would add $6,560,000, and raise CNJ's conclusion as to the total value of its alternative scenario rights foreclosed by the Act to $101,946,000. Insofar as these items do not fall with the collapse of CNJ's perception case, they lie beyond the scope of this proceeding—determination of the value of the conveyed assets as of April 1, 1976. *See* CMV Opinion, 445 F. Supp. at 1041; Sixth Pretrial Order ¶1.

8. Whitehurst testified that at the meeting of July 26, 1974, when Sagner requested the Peabody study he stated that:

> Mr. Timpany is going to come in with the highest number he can think of and the basis that gives him the highest number. And there is going to be a variety of bases, and we want to know what the possibilities might be as to different bases as part of the overall context of what are we going to do? You know, do we want to get into it or don't we want to get into it?

9. The Peabody Study treated CNJ's real estate as having a December 31, 1973, net value of $62,687,000. The Hyde Study estimated the net value of CNJ's property to be $96,449,000 as of October 1974.

10. By the term "base value" we mean the market value of the conveyed parcels as of the valuation date, April 1, 1976, before adjustment for title defects, discounting to present value, holding costs, and selling expenses.

11. Although CNJ developed typical property values for most of the conveyed property, it employed an income based valuation in its appraisal of a few of the parcels. In particular, the CNJ appraisers used an income based valuation method to value a tract on the Liberty Harbor waterfront that had been zoned for high density residential use. A few parcels that CNJ appraised for use as parking lots were valued on an income producing basis if no comparable sales could be found.

12. L.E. Peabody & Associates, Inc. conducted an appraisal of CNJ's assets for the New Jersey Department of Transportation between July and September of 1974. As part of its study, Peabody analysed CNJ freight traffic by line segment to determine the minimum trackage required to provide freight service to customers serviced by CNJ. The study examined 23 segments of CNJ track totaling 366.4 route miles. In its report, Peabody discussed the ability of other rail lines to service the areas then serviced by CNJ.

13. CNJ's appraisers assumed that depressions would not be filled prior to sale.

14. In fact, CNJ argued that the sale of the ballast and fill would produce $2.3 million in net proceeds. *See* Section IV.A., *infra*.

15. As the GPs point out, and we discuss in Section IV.A., *infra*, CNJ has not presented evidence on the expected demand for fill in the markets that CNJ could have supplied. As evidence that a market existed, CNJ relied on its discovery that Conrail has removed fill from conveyed property. CNJ did not present evidence regarding the use to which Conrail has put the removed fill nor any prices at which Conrail has sold fill. In the absence of more detailed evidence, we must assume that the market would have been slow to absorb 6.4 million cubic yards of fill.

16. Our conclusion that the presence of embankments may have had a negative effect on the value of the underlying real estate is consistent with our finding in Section IV.A., *infra*, that CNJ has failed to produce sufficient evidence to establish a positive NLV for its fill and ballast.

17. CNJ argues that its "original contours" assumption was an inconsequential factor in its appraisals because most of the land in question was level. As support for its argument, CNJ cites evidence that 92% of its right-of-way acreage in Essex County is level with adjacent property. *See* Simon Testimony, October 26, 1981, Exhibit 2, at 15-16. Using the same sources, however, we find that only 60% of the conveyed right-of-way acreage in Hudson and Union Counties is level with surrounding terrain. *See* Simon Testimony, *supra*, Exhibit 2, at 20-21; Barkan Testimony, October 26, 1981, Exhibit 3, at 15-16. CNJ does not indicate how much of the total appraised value of real estate is applicable to elevated property. It is entirely possible that the rights of way that have the most topographical variances are located in the most expensive areas. In the absence of additional information, we must assume that the use of the "original contours" assumption had a significant effect on CNJ's real estate estimates.

18. *See* note 12.

19. It is difficult to determine what sales the GPs actually relied on, except in individual instances covered in deposition testimony, because they did not file a list of the comparable sales used in their valuations.

20. Another widely recognized objection to the admission of subsequent sales data is that the price paid in any purchase of nearby property after the date of condemnation will have been artificially inflated by the enhancement of land values often brought about by the condemnation. *See United States* v. *320.0 Acres of Land*, 605 F.2d 762, 800 (5th Cir. 1979). Decisions can be found authorizing exclusion of evidence of such sales. *See United States* v. *Meadow Brook Club*, 259 F.2d 41, 46 (2d Cir.), *cert. denied*, 358 U.S. 921 (1958); *International Paper Co.* v. *United States*, 227 F.2d 201, 209 (5th Cir. 1955); *District of Columbia* v. *Lot 813 in Square 568*, 232 F. Supp. 714, 719 (D.D.C. 1964), *aff'd sub nom. Rubinstein* v. *District of Columbia*, 346 F.2d 833 (D.C. Cir. 1965). The weight of authority, however, has been to the contrary. The possibility that the prices obtained in comparable sales subsequent to the date of the taking have been influenced by the fact of the taking has been held to go to the weight, not the admissibility, of evidence of such sales. *See United States* v. *320.0 Acres of Land*, *supra*, 605 F.2d at 802-03; *United States* v. *1,129.75 Acres of Land*, 473 F.2d 996, 998-99 (8th Cir. 1973); *United States* v. *691.81 Acres of Land*, 443 F.2d 461, 462-63 (6th Cir. 1971); *United States* v. *79.39 Acres of Land*, 440 F.2d 1190, 1191 (6th Cir. 1971); *United States* v. *An Easement and Right of Way*, 405 F.2d 305, 308 (6th Cir. 1969); *United States* v. *63.04 Acres of Land*, 245 F.2d 140, 144 (2d Cir. 1957); *see also United States* v. *Meadow Brook Club*, *supra*, 259 F.2d at 49 (Lumbard J., dissenting). The condemnation here was unlike those in which property has

been taken for a new value enhancing use, e.g., farmland taken for conversion into a highway. The use remained the same; the only value enhancing factor would have been the removal of doubt with respect to continuation of rail services. Of course, sales taking place many years after the date of the taking would be far less relevant to the determination of a market price on that date than would sales immediately before or afterward.

21. Heaney testified that he and Hannoch relied on 34 sales before April 1, 1976 and 27 sales after that date in appraising the real estate in Essex, Hudson, and Union Counties. Hannoch/Heaney Deposition, December 10, 1981, at 115, 33 CNJ App. at 44A. The GPs maintain that more than half of the sales that Hannoch and Heaney used to value Elizabethport Yard and Brills Yard were post-April 1, 1976 sales.

22. The GPs contend that Van Horn furnished Hannoch and Heaney with:

> (A) the work papers from his 1978 appraisal, which included, as a step in Mr. Van Horn's calculation of liquidation values, the cost to remove abutments and retaining walls; (B) "control sheets" containing valuation section, map and parcel number, municipality, county and street location, acreage and zoning; (C) maps; and (D) comparable sales information.

GPs Opening Brief at D-43; *see* Motion, and Supporting Memorandum, of the Government Parties for an Order to Show Cause Why Central Jersey Industries, Inc. Should Not Be Compelled to Produce Certain Work Papers Relating to Their Real Estate Base Values, January 19, 1982, at 3-7. While not denying that the materials Van Horn furnished to Hannoch and Heaney contained all of this information, CNJ has argued that the GPs should not be granted access to these materials because Hannoch and Heaney only relied on them to determine the cost to remove abutments and retaining walls. *See* Objections of Central Jersey Industries, Inc., and Brief in Support Thereof, to Government Parties [sic] Motion of January 19, 1982, to Compel Production of Certain Documents, January 25, 1982, at 6. In an order giving the GPs access to these materials, Judge Thomsen reserved any ruling on the admissibility of the contents. *See* Order on Motion of the Government Parties for an Order to Show Cause Why Central Jersey Industries, Inc., Should Not Be Compelled to Produce Certain Work Papers Relating to Their Real Estate Base Values and Objections of Central Jersey Industries Thereto, January 27, 1982, Paragraph 2. CNJ has not objected to the admission of these materials. *See* Third Order Governing Receipt of Written Testimony, Deposition Transcripts and Other Materials in Evidence, November 19, 1982, Paragraph 2.

23. *See* Van Horn Deposition, February 16, 1982, at 45.

24. *Id.* at 119-20.

25. In their brief, the GPs contend that Van Horn relied solely upon data from sales prior to the valuation date in making his appraisals. GPs Opening Brief at D-70. The evidence indicates, however, that Van Horn did consider some sales after April 1, 1976. *See* CNJ Reply Brief at 83 n.*; Van Horn Appraisal (GPs), June 2, 1982, at 5.

26. *See* note 22.

27. In arriving at base values, CNJ and the GPs instructed their appraisers to assume that CNJ had fee simple title to all conveyed parcels.

28. Lacouture made no further deduction for the decrease in value of the remainder of a larger, otherwise marketable parcel when a small portion of it was found to have a title defect, even if the unmarketable portion provided frontage or access to the rest.

29. Our decision is in accord with the reasoning of Judge Posner writing for the Seventh Circuit in *Chicago & North Western Transp. Co.* v. *United States*, 678 F.2d 665, 670-71 (1982), which denied compensation for C&NW real estate held by adverse possession when state law provided reversion to previous owners if such land should cease to be used as railroad right of way.

30. The title insurer would inquire first into the disposition of the grantor's adjoining property and would, in any case, require indemnification by the seller.

31. CNJ adds a contention that owners of adjoining land who hold automatic reversionary rights would pay some price to remove clouds on their title created by CNJ's former interests. We concur in the GPs' response that no compensation is warranted for any "hold up" price CNJ may have hoped to receive on this account.

32. The DeLeuw Cather report called Wyer Dick's total real estate liquidation expenses "much too low," but did so on the basis that salaries of in-house personnel were computed only for a five year period. DeLeuw Cather did not find fault with the 10% figure for brokerage fees and related expenses.

33. The State of New Jersey has paid into court over $7 million for property taken in 1976 from CNJ in the Liberty Park area of Jersey City. CNJ has litigated this condemnation award, thus far with success, and has not included its considerable litigation expense in the computation of selling expenses as a percentage of gross proceeds.

34. The parties have stipulated that whenever a party seeks to apply a risk inclusive discount rate to proceeds figured in real dollars, that rate shall be 9.13% per 12-month period, and that whenever a party seeks to apply a risk inclusive discount rate to proceeds figured in nominal dollars, that rate shall be 15.22% per 12-month period.

35. We need not consider this possibility since such a buyer would have demanded a discount to compensate for the time he would have needed to resell the parcels and for other purposes considerably as great or greater than the discount considered here.

36. One example is the most valuable single piece of property—CNJ's Elizabethport Yard. This property, a freight and passenger car repair facility, contained 232 acres of conveyed property. In order to prepare the Elizabethport Yard for the industrial use which was agreed to be the highest and best, four abandoned and uninhabitable buildings would have to be demolished and several obstacles and abutments would have to be removed in order to create adequate access. Similarly, according to Hannoch and Heaney, the highest and best use for several of CNJ's other parcels (such as Ib/26/4 and Ib/26/2) was as parking lots. In order to make even this modest conversion, the properties would have to be cleared, levelled, and given adequate drainage.

37. Developable properties are properties that are marketable generally. Abutter properties are marketable, if at all, only to adjacent landowners.

38. Wiedeman and Moody who testified on behalf of the GPs concerning the pace of disposition of abutter right of way, assumed that a fixed percentage of abutter property would be sold each year. For CNJ properties located in Somerset, Middlesex, Camden, Burlington and Atlantic Counties, it was assumed that 20% of remaining abutter property would be sold each year. For the CNJ properties located in all other counties, it was estimated that only 15% of inventory would be sold each year.

39. These percentages relate only to those CNJ properties that the GPs concluded had positive economic value. The GPs divided CNJ's property into smaller parcels it called valuation units. These valuation units were then categorized as either "major properties," "abutter properties," "developable properties," or "other properties." No value was assigned to valuation units labelled as "other properties" as they were considered unsaleable. Seven percent of CNJ's land in the disputed counties was categorized as "other property."

40. The ICC also applied a "discount" to the market value of the New Haven's land "on the assumption that a certain portion of the land would remain unsold at the commencement of the final year of liquidation and full market value would not be realized." 331 I.C.C. at 662. Apparently the word "discount" was there used in the sense of a markdown to move the properties rather than a discount to reflect the lesser worth of future as against present payments.

41. Indeed, CNJ might have filed for abandonment even while negotiating, if only as a bargaining chip.

42. In fact, negotiation with the State of New Jersey would doubtless have continued, and might have lessened both the zeal of the Trustee in pursuing other sales and the likelihood of interesting prospective buyers. But the GPs cannot have it both ways. If, as they argue, the price New Jersey would have paid is to be determined by what CNJ could have obtained from others, the continued presence of New Jersey as a potential purchaser cannot fairly be taken into account as a price depressant.

43. This seemingly high figure reflects the large amount of preparatory work that would have been done in the 15 months preceding April 1, 1976.

44. CNJ would have us disregard property taxes entirely on several grounds. First, CNJ argues, local property taxes are already taken into account in arriving at the appraised base value of the real estate. Be that as it may, the taxes still must be paid until the property is sold, and we have determined that the conveyed real estate could not all have been sold on April 1, 1976. Second, CNJ contends that property taxes are completely offset by interim income from leases running on the conveyed real estate, the last of the topics to be considered in this section. With the parties' estimates for both items before us, we can make that determination for ourselves. Finally, CNJ argues that difficulties of proof make both property taxes and interim income impossible to quantify. Again the parties' estimates, quite close in result, belie the claim.

45. In taking appreciation of real estate into account in estimating local property taxes, Tesh adopted the appreciation forecasts of Eastdil for developable properties and Wiedeman and Moody for abutter properties. Because we have decided that these appreciation forecasts were too low, the real estate tax estimates should be adjusted to reflect the additional 3% annual appreciation mandated by this opinion.

46. Wyer Dick valued the ballast of CNJ at $208,000 in its study completed in 1970. In 1974, the Peabody Study adopted the Wyer Dick value for ballast as appropriate.

47. Storm's testimony with respect to the five removal sites that he or his associates observed is inconclusive. At the Newark Bay Bridge site and at the parcel near Doremus Ave. and the Passaic River, the only two sites where Storm actually saw removal operations, Storm did not know who removed the fill, what happened to it, or how much Conrail received for it. Storm Deposition, March 21, 1982, at 1249-51, 35 GPs Supp. App. at 314-16. With respect to the Newark/New York line removal site, Storm relied on the testimony of his associate Plum, who did not know who removed the material, when removal occurred, or how much was paid. Plum also did not know who removed ballast and fill from the EL's conveyed track or how much was paid for it. On a former LV line, Storm testified that he saw the results of fill removal but he did not know what happened to it, or whether it was paid for.

48. Cascading is the process of reusing rail, other track material, and ties that are replaced when lines are renovated with new or better quality materials. The replaced material is reused, or cascaded, in tracks having lighter duty requirements.

49. The GPs also point out that Storm did not assign any value to the EL's ties for landscape use when he served as overall project director of the Wyer Dick study to determine the EL's liquidation value as of 1976.

50. Rodola determined that the CNJ would have sold 174,430 ties for rail reuse and then subtracted from this amount 12,095 ties that had been installed with funds received under Section 215 of the Rail Act.

51. Mewhinney testified that he sold good quality reusable ties at prices in the $5.00-$5.50 range to railroads during 1973 and 1974. DeLeuw Cather, anticipating that there would be a severe shortage of used ties, estimated the market prices at $6.60 per tie for reusable rail ties and $5.50 per tie for other uses. DeLeuw Cather, Development of Standard Unit Salvage Values, 23-24, 3 CNJ App. at 418-19.

52. The track of a railroad consists of the ballast, ties, rail, and other track material (OTM) formed into a structure on which trains operate. OTM is the material which holds the track together, and it comprises spikes, tie plates, joint bars, bolts, and anchors. Turnouts are switches that divert trains from one track to an adjoining line.

53. Headwear is the wear to the surface of the rail that comes into contact with a train's wheels. The AREA table sets out four classes for use of rail: main line (Class I), branch line (Class II), light branch line (Class III), and yards (Class IV). For each class, the table assigns figures for maximum allowable headwear, both vertically and horizontally, for various weights of rail. The AREA table is a guide for determining the class of track in which a given rail can be relaid. *See* Rail Use Opinion, 531 F. Supp. at 1239 & n.95.

54. Storm's classifications were modifications of the AREA standard. Storm retained the four classes of rail but modified this classification system to eliminate the distinction between heavy and light branch line use. The stipulation of a single price for relay rail eliminated the need to distinguish between the various kinds of relay use. Storm's system also classified track by mile rather than by a specific piece of rail. *See* Storm Deposition, March 21, 1982, at 1363, 38 GPs Supp. App. at 575.

55. The Bechtel Study was conducted in 1974 by six independent engineering firms for the USRA. The purpose of the Bechtel Study was to provide the USRA with an objective assessment of the condition of the Transferors' properties. During the Bechtel Study, qualified railroad maintenance engineers sampled a seven-rail section (273-feet) of the track structure and right of way every two miles on each main and running track on the Transferors' lines. These engineers recorded the

condition of the rails, ties, ballast, surface, alignment, drainage, and vegetation for each sampled section.

56. The GPs, like the CNJ, relied on the Bechtel Study as their source of information on the condition of the CNJ's rail.

57. The GPs used the ¼ inch measurement because it is the maximum end batter that the Federal Railroad Administration allows for Class IV track. Class IV track is capable of carrying trains at speeds of 40-60 miles per hour, which is the appropriate speed for main lines and high density branch lines.

58. The GPs' expert, Morgan argued that the end batter criterion is appropriate because end batter could indicate other defects in the rail. We are more convinced by the testimony of Storm, who stated that end batter results from poor joint maintenance rather than poor rail maintenance and can be eliminated by cropping.

59. The GPs' data did not show the placement of the defects used to disqualify rail for reuse. Many such defects undoubtedly were located in the end of the rail because the rail joint is the most difficult area of the rail to maintain and contains defects not found in other parts of the rail, such as bulk hole cracks.

60. The value of controlled-cooled rail is largely in the elimination of transverse defects. Such defects are more likely to show up early in the life of the rail. Morgan/Gabriel Deposition, March 29, 1982, at 91-92, 3 CNJ App. at 157-58.

61. DeLeuw Cather reached this conclusion in a report to determine the net liquidation value of a portion of the Rock Island. The Rock Island's relay rail being considered for reuse weighed between 110 and 119 lbs. Report to the Southern Pacific Transportation Company on the Net Liquidation Salvage Value of the Missouri-Kansas Division—Chicago, Rock Island and Pacific Railroad Company, Volume 1-Facilities, November 25, 1977, at 29.

62. Of the rail 131 lbs. and over, Morgan and Gabriel classified 23,231.2 net tons out of a total 26,526.2 net tons as suitable and marketable for reuse. Storm classfied 22,939.38 net tons out of a total of 25,558.67 net tons as suitable and marketable for reuse. The difference results from Storm's decision to abandon in place all rail in grade crossings whereas Morgan and Gabriel assumed it would be recovered. Because we find the CNJ's methodology on suitability to be superior to that of the GPs, we conclude that Storm's figure is the appropriate one to use on rail weighing over 130 lbs.

63. The CNJ contends, based on its analysis of rail replacement rates, that as much as 75% of all track is non-controlled-cooled. *See* CNJ reply Brief at 164. Because engineering standards discourage the use of controlled and non-controlled-cooled rail together, the availability of non-controlled-cooled rail would have presented railroads a unique

opportunity to upgrade this kind of rail in their tracks. CNJ also presented substantial evidence showing that there would be a substantial demand for high quality relay rail to replace worn-out rail due to the general deterioration of the American railroad system in recent years. *See* Storm Rebuttal Testimony, June 2, 1982, at 8-9, 3 CNJ App. at 466-67.

64. It is difficult to determine from the record the exact amount of 130-lb. rail that the CNJ would have sold. We have calculated that Storm considered 16,930.178 tons of 130-lb. rail to be suitable and marketable for relay.

65. Both sides agreed that bolts, spikes, and anchors should be valued at scrap because this OTM would have deteriorated from wear or have been damaged during dismantlement.

66. Morgan and Gabriel for the GPs and Storm for the CNJ all agreed that the purchasers of CNJ's rail would have relaid this rail as continuously welded rail. Because the rail is welded, there is no need for angle bars or joint bars to hold the rail together. The CNJ failed to produce any convincing evidence that angle bars and joint bars would have been marketable separate from the rail with which they were associated.

67. The Rail Stipulation did not preclude the GPs from "introducing evidence that in transactions where other track material is sold together with relay rail, the price of the OTM per net ton would be the same as the price of the relay rail."

68. The valuation of turnouts is more complicated than the valuation of rail use and OTM. First, the rail and OTM in turnouts was classified for reuse or scrap in accordance with the classification of the rail they were associated with. Then, an excess (or incremental) value for the additional material in the turnout was calculated because the unique items in turnouts exceed in weight and cost the equivalent length of track material which they replace. The amount of excess weight and cost varies according to the weight of the rail and the size of the turnout. These incremental materials (the excess of materials in turnouts over materials in equivalent length of track) are valued at 75% of cost. These values are found in Appendix B of Storm's Testimony Concerning the NLV of the LNE, October 26, 1981, 3 CNJ App. at 453.

69. All of the GP's witnesses relied on the *American Metal Market* to find prices for scrap. Michaels testified that this publication is the most authoritative source of scrap steel prices and that the vast majority of scrap merchants rely on it. Michaels Testimony, October 26, 1981, at 5.

70. The GPs make other criticisms of the CNJ's methodology. The GPs contend that the use of *Iron Age* instead of the *American Metal Market* caused the CNJ to set their unit prices $4 higher than the GPs. Neither side, however, really explains the difference in prices or

attempts to prove which one is correct. The GPs also contend that the CNJ's use of scrap prices for the three months after April 1, 1976 inflated the price for scrap.

71. The CNJ makes other criticisms of the GPs' approach to determining the scrap price. CNJ argues that Kneafsey's model ignored that the Transferors may have enjoyed a distinct advantage over other scrap sources because of the large quantity of uniform grade scrap that the dismantlement process would generate. Kneafsey gave no consideration to the fact that the Transferors' scrap may be easier to gather than other kinds of scrap. Kneafsey Deposition, April 15, 1982, at 53, 3 CNJ App. at 28. The CNJ also points out that there were scrap shortages in 1972 and 1973 and that some sources anticipated that these shortages would recur later in the 1970's. *See* Hearings: Ferrous Scrap Export Controls Before the United States Senate Committee on Banking, Housing, and Urban Affairs, 93 Cong., 1st Sess. 273 (1973) (statement of Paul B. Akin, President of Laclede Steel Company, on behalf of members of the American Iron and Steel Association).

72. The CNJ had 173,390 untreated cross ties and 1,559 untreated switch ties in its inventory. Approximately two-thirds of these were located at the Kerr-McGee treatment plant in Avoca, Pennsylvania, with the remainder at a yard in McAllisterville, Pennsylvania. The inventory also contained 12,265 treated, unused cross and switch ties stored in CNJ's warehouses. *See* Morgan/Gabriel Testimony, February 16, 1982, Exhibit 4, at 7-8. (Report by Mewhinney Concerning Marketability of Reuse Ties).

73. The GPs reduced the base price of the CNJ's ties by 25% to account for all costs associated with disposition. As stated, we found this deduction to be too high. Our 15% figure reflects our approximation of a more realistic figure for the disposition costs of these assets.

74. It was unclear from the record how much rail was in the CNJ's rail inventory. We concluded this amount was 3276.76 net tons, and we valued this material at $84 per net ton. If this amount is incorrect, we are certain that the parties will make an adjustment for our error.

75. In their efforts to value the other materials and supplies accounts, both the GPs and CNJ relied on an inventory listing provided by CNJ with the help of its auditors, Haskins & Sells. The GPs discovered several inaccuracies in the inventory listing and would have us infer from those mistakes that the entire listing is tainted and the result of creative accounting. Because of the insignificant dollar amount of the errors the GPs discovered, the absence of an alternative inventory listing, and our general agreement with the values the GPs propound, we need not consider the GPs' challenge of the inventory.

76. Because the stipulated value of the OTM in inventory exceeds the book value of that asset, CNJ adopts the book value as its base value.

APPENDIX K

Appendix K

IN THE SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed Sep 20, 1983, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

Opinion on Petitions for Reconsideration on Valuation of the Central Railroad of New Jersey and the Lehigh & New England Railway for Nonrail Use

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

PER CURIAM:

In accordance with the first paragraph of Part VII of our opinion filed July 12, 1983, CNJ, the L&NE and the GPs have filed petitions for reconsideration and the adverse parties have responded. We rule as follows:

I. LOCOMOTIVES AND FREIGHT CARS

A. *Scrap Steel Prices*

CNJ objects to our pricing the steel in locomotives and freight cars that would be scrapped at $76 per ton, the figure that the GPs had proposed for all steel scrap, rather than at the CNJ's figure of $84 per ton, which we adopted for rail (pp. 55-58). The GPs concede the point and we accept the concession. However, we agree with the GPs that the $84 price should be applied to the tonnages calculated by the GPs' experts Mauro and Michaels rather than to the somewhat higher tonnages estimated by CNJ.

Appendix K

The GPs object to our valuation of eight MD SD40 road freight locomotives which admittedly were marketable for reuse (p. 68). We adopted the Wyer Dick valuation of $1,971,000 which had been calculated on the basis of $219,000 for each of 9 locomotives. In fact one had been disposed of before the Wyer Dick study. The $219,000 figure should thus be applied to only 8 such locomotives for a total of $1,752,000.

The CNJ objects to our use (p. 70) of a figure of $5,330 per unit for its gondola cars and says the correct figure is $6,569. It is unnecessary to state the reasons since the GPs agree.

In its answer to the GPs' petition for reconsideration CNJ urges for the first time that the GPs' expert Dunn erred in valuing at zero 112[1] of the 496 freight cars valued as scrap because their value was less than the balance owing under a Conditional Sales Agreement (CSA), a methodology which we accepted—concededly without objection from CNJ. CNJ argues that the only deduction should have been for $94,181, the amount of CSA payments accruing after April 1, 1976, rather than the full amount of the CSA payments. The basis for this is a claim that "These overdue payments were satisfied by CNJ at the time of its reorganization and only the final installment on the CSA (due 10/1/76) was to be paid by ConRail." We do not pass on the merits of the argument since it comes too late for consideration in this valuation proceeding and the factual assertion is without record support. Our ruling is without prejudice to CNJ's advancing a claim against Conrail for unjust enrichment from this transaction in any court of appropriate jurisdiction if so advised.[2]

The following tables represent our recalculation of the value of CNJ's locomotives, freight cars and cabooses and other equipment accounts:

Appendix K

Locomotives

Description	*Year Built*	*No. of Units*	*Unit Value 4/1/76*	*Total*
EMD Switcher SW1	1939-42	4	9,700	38,800
EMD Switcher NW2	1942	2	9,700	19,400
EMD Switcher SW7	1950	4	9,700	38,800
EMD Switcher SW9	1951-52	11	22,000	242,000
EMD Road Switcher	1952	11	5 x 30,000	150,000
GP7, 7P			6 x 9,700	58,200
ALCO Road Switcher RS2	1950	8	9,700	77,600
ALCO Road Switcher RS3	1951-53	18	9,700	174,600
EMD Road Freight SD35	1965	12	182,000	2,184,000
EMD Road Freight SD40	1967	8	219,000	1,752,000
				4,735,400

Freight Cars and Cabooses

Description	*Year Built*	*No. of Units*	*Unit Price 4/1/76*	*Total*
Box Cars	1957	34	1,300	44,200
Equipped Box Cars	1956-57	12	1,300	15,600
Gondolas	1957-65	51	6,569	335,019
Covered Hoppers	1956-57	131	87 x 3,453	300,411
			44 x 1,500	66,000
Cabooses	1942	29	1,300	37,700
		257		798,930
Covered Hoppers		176	1,500	264,000
Covered Hoppers		105	CSA	0
Flat Cars		9	1,700	15,300
Box Cars		163	1,300	211,900
Open Hoppers		26	1,500	39,000
Cabooses		10	1,300	13,000
Gondolas		7	CSA	0
		496		543,200
TOTAL		753		1,342,130

Appendix K

Other Equipment Accounts

Description	*Total*
Roadway Sm. Tools	14,000
Roadway Machinery	400,000
Shop Machinery	379,000
Power Plant Machinery	4,000
Passenger Cars	6,000
Work Equipment	290,000
Misc. Equipment	53,000
	1,146,000

Summary

Locomotives	4,735,400
Freight Cars and Cabooses	1,342,130
Other Equipment Accounts	1,146,000
	7,223,530
Equipment Obligations	−1,356,000
	5,867,530

II. Ties

CNJ and L&NE attack our reliance (pp. 44-45, and 94) on the valuation made in 1978 by Rodola, Wyer Dick's project manager for the study of the CNJ's liquidation value, as supported by the testimony of GP witness Mewhinney. As it has done throughout this proceeding, CNJ does not adequately recognize that the issue with respect to ties is not simply reusability but also marketability, and it has failed to supply any estimate that we could reasonably accept. With the CNJ's figure clearly too high and the GPs' too low, we continue to believe that the amounts fixed in our opinion represent the best solution available on the record.

Appendix K

III. Real Estate

A. *Testimony of Hannoch and Heaney*

CNJ criticizes the portion of our opinion (pp. 14-16) which concluded that its appraisers, Hannoch and Heaney, "employed two assumptions that detract significantly from the reliability of their estimates." One was "that all CNJ real estate would continue to be served by a rail line if the purchaser so desired." CNJ argues that Hannoch and Heaney assumed continued rail service only "in those areas where rail was a factor to the users of land." Hannoch/Heaney Deposition, March 24, 1982 at 750, 5 CNJ App. at 0084. Our criticism, still unanswered by CNJ, was that this assumption was unjustified and that the record supplied no way to adjust for the error. The other assumption was that, with respect to embankments, the land would be returned to its original contours prior to sale, this being based on the premise that fill materials could be sold on site for a price greater than the cost of removal. CNJ now argues that any error on this score had only minor effect and has presented tables, purportedly constructed from the record, showing that 94.2% of the values in Essex County, 95.4% of the values in Hudson County, and 79.17% of the values in Union County were in level parcels; it suggests that we adopt the Hannoch-Heaney valuations for the level parcels and the Van Horn valuations for the balance. The GPs object that the proposal comes too late since it would deny them opportunity for cross-examination and rebuttal of the classifications now made by CNJ counsel. We agree. CNJ knew all along that the topography issue was very much in the case. At this late stage it will not be allowed to reverse its tactical decision to go all-out for the Hannoch-Heaney approach to that issue.

B. *Adjustments to Van Horn valuations*

On the other hand, we agree with some but not all of CNJ's arguments that Van Horn's valuations require upward adjustment.

Appendix K

1. *Bridge dismantlement and removal costs*

The parties had entered into a stipulation on February 5, 1982, that the NLV of CNJ's bridges should be taken as zero. Sp. Ct. Rptr. NO39193. However, Van Horn had deducted $559,000 for bridge removal costs and CNJ asks that this be added. The GPs concede that an adjustment should be made. However, they disagree with the amount since they had already made a partial adjustment by valuing at zero parcels where Van Horn's appraisal showed a negative value after removal. We find that an upward adjustment of $349,800 is required.

2. *Omitted parcel*

Both sides agree that an upward adjustment of $75,000 should be made because of Van Horn's omission of a parcel in Union County designated as Ig/2/3.

3. *Title Defects*

CNJ argues that we have double-counted in making an adjusted deduction of 7.162% from base value for title defects on the basis of the testimony of Lacouture (pp. 21-23) and that Van Horn made an adequate deduction for this factor.

The workpapers supplied in the appendix to CNJ's petition for rehearing (5 CNJ App. at 0002) show that it has considerably exaggerated the impact of what Van Horn did on this score and that it is feasible to make an adequate adjustment for double counting without rejecting Lacouture's careful study. The workpapers relate to only 21 parcels with a total area of 116.3 acres. Of these Van Horn considered title to 28.9 acres to be impaired and to 87.4 to be unimpaired. However, of the 28.9 acres with impaired title he valued 20.9 at $118,500. With but one exception (parcel Ib/9/2) Van Horn valued impaired and unimpaired portions of the same parcel at the same per acre price and applied the same liquidation factor. In other words, when Van Horn did assign value to land with impaired title, he made no

deduction for the impairment. Accordingly, there is no double counting in applying Lacouture's discount to the valued acreage. This leaves only 8 acres to which Van Horn ascribed no value because of the impairment. In all but a few instances it is possible to value these impaired acres at the same price per acre as unimpaired portions of the same parcel and then apply Lacouture's discount. Where this is not possible because the entire parcel suffered an impairment, and imputed value (i.e., what the land would be worth but for the impairment) can be reached, perhaps a bit too favorably to CNJ, on the basis of the average per-acre price of all valued parcels, to wit, $12,400 per acre, or a total of $163,700. Van Horn's base value should be increased by that amount, less the generally applicable 7.162% deduction for title defects, or a net increase of $151,976.

4. *"Free standing" parcels*

CNJ objects that Van Horn appraised certain parcels without regard to the higher price they would have commanded if sold along with retained parcels. The latter method of valuation would have been permissible, see *Olsen* v. *United States*, 292 U.S. 246, 256, (1934), and apparently was adopted by the appraisers for both CNJ and the GPs. However, it is impossible to determine how much Van Horn would have increased his valuations if he had adopted the approach now urged.

5. *Appreciation from 1974 to April 1, 1976*

CNJ urges that since Vane Horn used 1974 market values, these should be adjusted upward by 8% to reflect appreciation to April 1, 1976. The issue is problematic. Van Horn used some comparable sales that were later than 1974 and some that were even later than April 1, 1976 (Opinion, p. 19), although he used earlier ones as well. Although he was of the opinion that there had been appreciation between 1974 and April 1, 1976, of "less than 10 percent", he refused to set a percentage or to say that an

adjustment was required. Wyer Dick's former president, Shannon, a witness for CNJ, testified that real estate values in Northern New Jersey had declined, as did the GPs' witness Eastdil. Although we could well stand on our opinion, we have determined that in the interest of entire fairness to CNJ, Van Horn's base value should be increased by 3% to reflect appreciation to April 1, 1976.

6. *"Rapid Sale" Valuation*

CNJ contends that we should not have discounted Van Horn's base values because Van Horn included among "liquidation factors" a component calculated to bring about "rapid sale" of the real estate. Van Horn's testimony as to what he meant by "rapid sale" is vague.[3] It is clear that his "rapid sale" assumption was not the same as a "forced sale" or "distress" price valuation, see GPs' Opening Brief at G-19 to G-23. There is nothing to indicate that he assumed a particularized pace of sale and applied discounts to reflect this. To the contrary he testified that a particularly ill-situated parcel would be disposed of under his "rapid sale" approach in "something less than eight years". We have determined that 55% of the conveyed real estate would be sold in the first two years and that only 5% would remain to be sold in the 8th year, and there is no way to tell how much more rapid pace Van Horn assumed. However, again in the interest of complete fairness to CNJ, we will increase his base values by another 3% in order to protect against possible double discounting.

IV. Liquidation Organization and Disposition Costs

The GPs contend that we erred in rearranging the order of the steps by which the GPs' witness Murphy updated Wyer Dick's 1968 study of these costs. According to the GPs, the subtraction of certain double-counted costs (Opinion, p. 88) should have preceded our adjustment for the decrease in the size of CNJ's

operations from 1968 to 1976 and the division between CNJ's conveyed and retained assets on pp. 84-87 of the opinion.

Our original reading of Murphy's testimony was that he meant the double-counted costs for trackwork and real estate disposition to reflect solely those expenses attributable to the conveyed assets, as measured by the GPs' witness Tesh and as reflected in the dismantlement stipulation. However, we conclude that the GPs are correct in stating that the numbers Murphy used are those of the 1968 Wyer Dick study updated to 1976 and reflect a larger "whole" CNJ. We therefore sustain the GPs' contention that the double-counted costs should be subtracted before applying our successive 40% and 37.6% reductions, in the general manner set forth on p. 14 of their petition for reconsideration.

V. Method of Discounting

Although neither petition for reconsideration raises a question as to the method for discounting payments to be received and made after April 1, 1976, comparison of the method of discounting used on the last page of the GPs' recalculation of liquidation organization and disposition costs (GPs' Petition, Exhibit 3) and that used by CNJ in connection with its pace of sale argument (CNJ's Petition, p. 17), makes it evident that the parties differ in their application of the stipulated 9.13% discount factor. Although we could leave this for the parties to work out in their discussions on an agreed judgment (Opinion, pp. 97-98), we think it preferable to instruct that all proceeds and expenses for a given year should be treated as being received or paid at the mid-point of the year.

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We have carefully reviewed such other points as are raised in CNJ's petition for reconsideration. Almost all of these constitute reargument for issues already considered and decided and do not merit further discussion.

The parties shall now proceed as directed by the final paragraph of our opinion filed July 12, 1983.

HENRY J. FRIENDLY

.....

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

.....

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

.....

Roszel C. Thomsen
Judge

Appendix K

FOOTNOTES

1. These were 105 covered hoppers and 7 gondolas, see Opinion pp. 70 and 77. The GPs' petition for reconsideration had not injected the issue, as CNJ's answer intimates; the GPs simply followed a methodology to which CNJ had never objected and which CNJ had used in its opening brief.

2. If the GPs should consider CNJ's claim to be meritorious, they are, of course, free to accept it in this proceeding, in whole or in part.

3. He defined the term to mean an attempt to reach a value "at which sale could be made without any undue delay and, in fact, without what might be considered a normal waiting time for the sale of property." Van Horn Deposition, June 29, 1982, at 151-52.

APPENDIX L

Appendix L

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed Dec 5, 1983, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER SECTIONS 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

ORDER MAKING CERTAIN FINDINGS AND DETERMINATIONS PURSUANT TO SECTION 306(c)(4) OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

On July 12, 1983, the Court issued its Opinion On Valuation of the Central Railroad of New Jersey and the Lehigh & New England Railway for Nonrail Use ("CNJ Opinion"), and on September 20, 1983, the Court issued its Opinion on Petitions for Reconsideration with respect to the CNJ Opinion.

On November 1, 1983, pursuant to the final paragraph of the CNJ Opinion, proposed forms of judgments together with supporting memoranda were separately submitted by the United States of America and the United States Railway Association (together "the Government Parties") and Central Jersey Industries, Inc. ("CJI"), on behalf of the Central Railroad Company of New Jersey and six affiliated transferors, Communipaw Central Land Co., Dover & Rockaway Railroad Co., Mt. Hope Mineral Railroad Co., Wharton & Northern Railroad Co., Bay Shore Connecting Railroad, and Central Railroad Co. of Pennsylvania (hereafter "CNJ and its affiliates"). As reflected in these memoranda, the parties have agreed that the value of other benefits and

compensable unconstitutional erosion, within the meaning of Sections 306(c)(4)(B) and (C) of the Regional Rail Reorganization Act of 1973, as amended (the "Rail Act"), are zero for CNJ and each of its affiliates.

The Court has considered the proposed forms of judgment and supporting memoranda submitted by the parties, has taken due note of all prior submissions and proceedings in this case, and hereby finds and determines as follows:

1. The total net liquidation value, within the meaning of Section 306(c)(4)(A) of the Rail Act, of the rail properties conveyed by CNJ and its affiliates pursuant to Section 303(b) of the Rail Act, is $42,509,299 as of April 1, 1976.

2. The value of other benefits, within the meaning of Section 306(c)(4)(B) of the Rail Act, provided to CNJ and its affiliates, and each of them, is zero.

3. The compensable unconstitutional erosion, within the meaning of Section 303(c)(1)(A)(i) and Section 306(c)(4)(C) of the Rail Act, suffered by CNJ and its affiliates, and each of them, is zero.

4. The following proceedings are established in order for the Court to determine the proper allocation among CNJ and its affiliates of the total net liquidation value set forth in paragraph 1, above.

a. Within 15 days of the date of this Order CJI shall file with the Court a statement containing its proposed allocation of the total net liquidation value set forth in paragraph 1, above, including a general explanation of how that allocation was made and furnish a copy of such statement, together with information as to the deadlines established herein, to the following:

i. each individual or entity who is a stockholder or creditor of any of the affiliates named above, and any other individual or entity holding a vested or contingent interest in the amount to be determined under Section 306(c)(4) of the Rail Act as the base value of the certificates of value of any of such affiliates; and,

ii. each individual or entity holding a vested or contingent interest in any securities issued pursuant to CJI's Plan of Reorganization which, pursuant to that Reorganization Plan, are to be liquidated from the proceeds (including interest) of this litigation.

b. Within 15 days of the date of this Order, CJI shall furnish to the Government Parties copies of all workpapers and any other documents necessary to understand how CJI arrived at its proposed allocation of the total net liquidation value set forth in paragraph 1, above, and CJI shall make available for inspection, at a convenient location and upon reasonable notice, a copy of all such workpapers and other documents to any individual or entity described in subparagraph a, above.

c. Within 45 days of the date of this Order, any person objecting to CJI's allocation among CNJ and its affiliates of the total net liquidation value set forth in paragraph 1 above, shall file with this Court a statement setting forth such objections together with a memorandum explaining each objection and its proposal(s) for an alternative allocation.

d. Upon receipt and consideration of such objections, the Court will determine if a hearing should be held. If no objections are received, the Court will enter an order approving the allocation proposed by CJI.

Appendix L

This order and the findings and determinations made herein shall not be effective and shall not constitute a finding or determination within the meaning of Section 303(d) of the Rail Act until the entry of Final Judgment by this Court making findings and determinations pursuant to Section 303(c) of the Rail Act.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: December 5, 1983

APPENDIX M

Appendix M

IN THE SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed Dec 5 1983, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

Memorandum Accompanying Judgment under § 306(c)(4) of the Rail Act on Valuation of the Central Railroad of New Jersey and the Lehigh & New England Railway for Nonrail Use

Before FRIENDLY, Presiding Judge, and WISDOM and THOMSEN, Judges.

PER CURIAM:

On September 20, 1983, this court filed its opinion (Reconsideration Opinion) on petitions for reconsideration of its opinion of July 12, 1983, with respect to the valuation of the Central Railroad of New Jersey (CNJ) and the Lehigh & New England Railway (L&NE) for nonrail use. We directed the parties to proceed in accordance with the final paragraph of our opinion of July 12 (CNJ opinion) which required them within 21 days to submit an agreed judgment fixing the net liquidation value of the properties conveyed or, if they were unable to agree, separate proposed judgments together with memoranda explaining the points of difference. At the request of the parties we extended the date for doing this to November 1, 1983. We then received proposed judgments and memoranda from CNJ and the GPs and a statement from the Receiver of the L&NE.[1] The CNJ and the

1. The statement recited that the Receiver and the GPs had agreed on a net liquidation value (NLV) of $1,997,000.00 for the property conveyed by the L&NE and that the issues of VOB and CUE should not be litigated, but requested that we defer the entry of judgment until

GPs have agreed that value of other benefits (VOB) and compensable unconstitutional erosion (CUE) shall be taken as zero, as have the various settlements we have approved, see also fn. 1, and the judgments submitted by both sides make provision to that effect. The GPs' memorandum also advises (p. 3) that "a great number of minor differences as well as several items involving more significant values have been compromised," and that agreement had been reached with respect to the NLV of the Raritan River as well as of the L&NE. However, the parties have been unable to resolve their differences with respect to four points, which they submitted to us for decision. We shall discuss these in the order in which they are presented in the GPs' memorandum:

I. Discounting

In the CNJ opinion, we rejected CNJ's claim that real estate proceeds, projected to be received over a period of time after July 1, 1976, did not need to be discounted to net present value as of that date (pp. 28-31). We found that eight years was a realistic schedule for disposition of such properties (p. 35). In the Reconsideration Opinion we directed that "all proceeds and expenses for a given year should be treated as being received or paid at the mid-point of the year" (p. 13).

Despite the seeming clarity of these rulings, CNJ now claims that all of the first year's proceeds should be regarded as having been received on April 1, 1976—with no appreciation being computed or discount taken. In the second year it appreciates base values and applies discounts for only six months. By following this procedure for each following year, CNJ eliminates a full year of discount, thereby adding $1,520,961 to the figure that would otherwise obtain.

CNJ seeks to justify this result on the basis of the time before April 1, 1976, which its Trustee would have had to expend in

after a hearing before the District Court for the District of New Jersey on November 14, 1983; the GPs agreed with this.

negotiations, which would have been concentrated on the more valuable properties. But the CNJ opinion (pp. 33-35) shows that we took account of precisely these facts in fixing a pace of sale much more favorable to CNJ than the GPs had proposed, with 35% of the real estate values being realized in the first year. CNJ's present proposal would involve double counting, is clearly contrary to our opinions, and should not have been made.

II. Addition of 3% per annum for Depreciation

In the CNJ opinion, Part III.B.3., under the general heading "Adjustments to Base Value" and the subheading "Discount to Present Value," we dealt, at pp. 35-37, with CNJ's contention that amounts realized from the sale of real estate after April 1, 1976, should be adjusted upwards from base value because of post-April 1, 1976 appreciation. After noting difficulties with the GPs' approach to this problem and the absence of any comprehensive treatment by CNJ, we found "that, as a matter of judgment applied to the record, 3% per annum should be added to real estate base values to reflect appreciation not taken into account in the GPs' figures." The GPs read this as meaning what it says. "Base value" is defined in fn. 10 to mean "the market value of the conveyed parcels as of the valuation date, April 1, 1976, before adjustment for title defects, discounting to present value, holding costs, and selling expenses." As the structure of the opinion makes clear, allowance for appreciation is a part of the discounting process. The GPs have therefore applied the 3% annual appreciation allowance to the base values found (pp. 20-21) or stipulated, in accordance with our findings (p. 35) with respect to the pace of sale.

CNJ proposes instead to add this 3% appreciation allowance to the appreciation rates, ranging from 0% to 5%, to which the GPs' experts had testified for various counties and types of property, and then apply the sum to the base values. This is not a fair

reading of the CNJ opinion. CNJ argues that use of a 3% rate in the hypothetical case on p. 37 of the opinion unsurprisingly would produce less than a 5% rate, which we thought inadequate if the property had in fact appreciated by 50% before being sold in the third year, whereas, an 8% rate would come closer to the actual figure. This elementary arithmetic overlooks that, as the CNJ opinion states (p. 37), there were only a few cases where the GPs' experts had recognized rates as high as 5% per annum. Our objective was to provide, as a matter of judgment, an overall appreciation rate to be applied to the new base values found in the CNJ Opinion. We thought, and still think, we had made that clear. If we did not, we do so now.

The GPs and CNJ agree that if allowance is to be made for appreciation of the values of the real estate, some upward adjustment should also be made for interim income from such property—a point which we overlooked. They differ with respect to the appreciation rate. CNJ advocates the same 3% rate used for appreciation of the base values. The GPs contend that, for reasons developed in their memorandum, interim income would not increase so rapidly and propose a figure of 1½%. We agree with the GPs.

III. Discounting of Proceeds of Assets other than Real Estate

CNJ's theory that no discount should be applied to proceeds received in the first year after April 1, 1976, leads it to propose that no discount be applied to the proceeds from non-real estate assets, for which the GPs' evidence established liquidation periods ranging from nine to fourteen months. We find no sufficient basis in the record to support CNJ's assertion that payment for all these assets could have been received on or shortly after April 1, 1976. Indeed, it would have been impossible for CNJ to deliver these assets on the date when operations ceased even on the

assumptions, favorable to CNJ, which we have made in rejecting the GPs' proposal for a deduction for winddown costs, CNJ opinion, pp. 78-81. We thus uphold the position of the GPs on this point also.

IV. The Value of CNJ's Interest in the Raritan River R.R.

The CNJ opinion referred, fn. 1, to the fact that as owner of 49.9% of the preferred stock of the Raritan River R.R. CNJ was entitled to 49.9% of the first $1,981,600 of the value of the Raritan River,[2] and, as owner of all the common stock, to any amounts above that figure. We did not make any valuation of the Raritan River, but the CNJ and the GPs have agreed that its NLV as of April 1, 1976, was $1,733,000. It would seem that the ensuing calculation should be quite straightforward. Since the agreed NLV of the Raritan River was less than $1,981,600, an addition of $863,034 ($1,733,000 x .498) should be made to CNJ's certificate of value under § 306(c)(4)(A), and interest on that sum at a compounded annual rate of 8% would be added under § 306(c)(4)(D). This is what the GPs propose.

In a complete change of front from positions previously taken, CNJ would now add to the $1,733,000 NLV of the Raritan River $1,413,608 of statutory interest to December 31, 1983, for a total of $3,146,608. Of this CNJ would receive $987,000 as 49.8% of the first $1,981,600, plus the excess of $3,146,608 over $1,981,600, to wit, $1,165,008, for a total of $2,152,008. This sleight of hand results in CNJ's receiving $2,152,008, whereas the owner of the remaining 50.2% of the preferred stock receives approximately $994,600.

Interest cannot so easily be transmuted into principal. If it had been possible to compute and pay the amount due on April 1,

2. It now turns out that the correct figure is 49.8%. The balance of the preferred stock was owned by the Penn Central and, by virtue of the settlement with the Penn Central, is now owned by the Government.

1976, CNJ would have received $863,034, which it could have used as it saw fit, as the owner of the other 50.2% of the preferred stock could have done with the slightly higher amount receivable by it. CNJ is entitled to that amount plus statutory interest and no more.

The only other difference between the proposed orders making findings and determinations pursuant to § 306(c)(4) of the Act submitted by CNJ and the GPs is that the CNJ proposed order would have the court now determine that the total amount of the NLV should be allocated between itself and six affiliated transferors in a manner proposed by it, whereas the GPs' proposed order would direct CNJ to file its proposals[3] and give the affiliates an opportunity to object. We deem the GPs' approach to be preferable. Accordingly, we are signing the order under § 306(c)(4) proposed by them.

Entry of an order under § 306(c)(4) does not end our obligations with respect to CNJ in these proceedings; we must then enter an order under § 303(c). CNJ has indicated that it wishes to raise three points in connection with such an order. These are: (1) a claim for severance damages with respect to the Newark Bay Bridge; (2) a claim that the compounded annual 8% rate of interest with respect to the certificates of value provided in § 306(c)(4) is constitutionally inadequate; and (3) a claim that, for a variety of reasons, the NLV of the CNJ as determined by this court does not satisfy the concept of constitutional minimum value. CNJ observes that it believes this court has rejected the third claim, citing pp. 81-82 of the CNJ opinion[4]—an observation in which we concur. Seemingly, it does not wish to produce further evidence or engage in further argument on this claim, which would be fruitless so far as this court is concerned, but desires only that our overruling of its position be again reflected in

3. These will now have to be altered to conform to this memorandum.

4. Reference should also be made to our CMV opinion, 445 F. Supp. 994 (1977).

the § 303(c) judgment in order to insure its consideration by the Supreme Court, if the Court is so advised. While the first two claims have been the subject of some testimony and comment, they have never been presented to us in a form enabling us either to pass upon our jurisdiction to decide them or, if we have this, to rule upon them. CNJ has presented an order to show cause with respect to further proceedings under § 303(c) but we find this unsatisfactory, in part because it would take the parties into extensive exploration of the facts before we determine whether we have jurisdiction or, if we find that we do, whether CNJ would be entitled to relief even on its own version of the facts.

We direct the parties to proceed as follows:

1) Within 14 days after the entry of our order under § 306(c)(4), the GPs shall file and serve on CNJ a motion for the entry of an order under § 303(c) in a form which shall be attached to the motion.

2) Within 17 days after the filing and service of the GPs' motion, CNJ shall file and serve an answer setting forth its objections to the entry of the proposed order. The answer shall be accompanied by a memorandum and/or affidavits. These shall include a statement of the relief which CNJ desires and a further statement whether CNJ believes this court has jurisdiction to grant such relief and, if so, why; the facts and the law contended to be relevant to each objection; and an offer of the proof which CNJ would propose to present in its support.

3) Within 14 days after the filing and service of CNJ's answer, the GPs shall file and serve a reply. The reply shall be accompanied by a memorandum and/or affidavits. These shall state the position of the GPs with respect to the jurisdiction of this court to grant the relief sought by CNJ and the reasons for such position, and the GPs' position on the merits, and shall also indicate the nature of the

proof which the GPs would submit if this court should decide that it may and should entertain CNJ's objections.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: December 5, 1983

APPENDIX N

Appendix N

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed Jun 15, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

CNJ OPINION ON INTEREST AND SEVERANCE DAMAGE

Before FRIENDLY, *Presiding Judge,* and WISDOM and THOMSEN, *Judges.*

FRAZER C. HILDER, UNITED STATES RAILWAY ASSOCIATION, WASHINGTON, D.C., FOR UNITED STATES RAILWAY ASSOCIATION.

STANLEY WEISS, DEAN R. MAY, AND ALEXANDER COHEN, CARPENTER, BENNETT & MORRISSEY, NEWARK, NEW JERSEY, FOR CENTRAL JERSEY INDUSTRIES, INC.

LAURENCE Z. SHIEKMAN, KENNETH I. LEVIN, PEPPER, HAMILTON & SCHEETZ, PHILADELPHIA, PENNSYLVANIA, FOR CONSOLIDATED RAIL CORPORATION.

FRIENDLY, *Presiding Judge:*

This court filed an opinion on July 12, 1983, *CNJ Opinion*, 571 F. Supp. 1269, and, on September 20, 1983, an opinion on reconsideration, *id.* at 1335, fixing the net liquidation value (NLV) of the Central Railroad of New Jersey (CNJ) (now, as a result of reorganization, Central Jersey Industries, Inc.), including the

Lehigh & New England Railway. The latter opinion, *id.* at 1340, directed the parties to proceed as instructed by the final paragraph of the former, *id.* at 1335. This required them to indicate, at the time when a proposed judgment or proposed judgments were submitted,

> whether they agree that the court may take the net liquidation value as the base value of each certificate of value under § 306(c)(4) of the Act or whether either side desires to litigate the issues of the value of other benefits and compensable unconstitutional erosion as provided in §§ 306(c)(4)(B) and (C).

Central Jersey Industries, Inc. (CJI) filed a memorandum dated November 1, 1983. This took the position that although the parties were willing to agree that the values of other benefits and compensable unconstitutional erosion were zero (as had been done in the various settlements we have approved) and the case was therefore ripe for the entry of judgment fixing the base value of the certificates of value (CVs) under § 306 of the Rail Act, we must pass on three other issues before we could properly enter judgment under § 303 that the conveyance in exchange for the CVs was fair and equitable. These were:

> (a) the severance damage caused to CNJ's retained Newark Bay Bridge property by the mandated conveyances;
>
> (b) the constitutional insufficiency of the interest accruing at an 8% compound annual rate on the certificates of value; and
>
> (c) the values transferred for ConRail's continued use which are not adequately measured by the net liquidation valuation standard called for in Section 306.

CNJ Memorandum In Support of Proposed Form of Judgment at 1.

On December 5, 1983, we entered an order finding that the total net liquidation value, within the meaning of § 306(c)(4) of the Rail Act, was $42,509,299 as of April 1, 1976 and, in accordance with the agreement of the parties, that the values of other benefits and of compensable unconstitutional erosion were zero. In an accompanying memorandum, also dated December 5, 1983, we explained how we had arrived at the figure. We also stated that

> [e]ntry of an order under § 306(c)(4) does not end our obligations with respect to CNJ in these proceedings; we must then enter an order under § 303(c).

We took note of the three points CNJ desired to raise, agreed with its concession that we had already rejected the third, and prescribed steps designed to assist us in formulating an order with respect to further proceedings under § 303(c). Although we had raised the question of our jurisdiction to consider CNJ's claims, both sides agreed that we had this. They relied upon § 303(c)(1)(A), which requires us to find whether the transfers or conveyances in exchange for the CVs "are in the public interest and are fair and equitable" to the transferor, and upon § 209(e)(B), which gives us original and exclusive jurisdiction of any civil action "challenging the constitutionality of this Act or any provision thereof."[1] Our order established procedures for the taking of further evidence, briefing and oral argument.

"*Fair and Equitable*"

On three previous occasions we have addressed ourselves to the meaning of the phrase "fair and equitable" in § 303(c)(1)(A) and the related issue whether

> the Act involves a taking and, if so, whether the "constitutional minimum" required both by the terms of the Act

> and by the Fifth Amendment differs if the Act should be regarded as a reorganization statute enacted under the bankruptcy power or as a statute enacted under the commerce power or as both.

CMV Opinion, 445 F. Supp. 994, 999-1000 (1977). In our Memorandum and Order dated June 16, 1976, printed as a appendix to our opinion of October 18, 1976, 425 F. Supp. 266, 276, we noted the question, raised in our letter of March 9, 1976, which led to the Memorandum, what function these words served,

> especially in view of the facts (a) that if the consideration is "fairer and more equitable than is required as a constitutional minimum," § 303(c)(3) requires us to eliminate the excess, and (b) that if the consideration were less than the constitutional minimum, it would not be fair and equitable.

Id. at 279. We went on to say:

> Almost all, perhaps all, the statements seem to agree that the fair and equitable language serves no significant function in the determination of the value of any particular property .... Accordingly the Court will consider the "fair and equitable" issue to have been removed from the process of valuing the properties of individual estates or other transferors unless this is raised in the briefs to be filed as above indicated; any person taking such a position shall state with precision and not merely in conclusory terms how the "fair and equitable" test differs from the constitutional minimum test with respect to valuation in the context of the Act as it now stands.

Id. In the October 18, 1976 opinion we said, to much the same effect, 425 F. Supp. at 269 (footnote omitted):

> Here again most of the parties share our inability to discern why, under the terms of the Rail Act, the requirement that we find that the consideration is more than, less than, or equal to the "constitutional minimum" does not drain the "fair and equitable" language of all meaning as regards the adequacy of the total consideration to be received by each transferor.[2]

In our *CMV Opinion*, *supra*, 445 F. Supp. at 1000, we noted that the issue had

> lost much of what once seemed to be its significance because of the concession of the Government parties (Brief at 12):
>
> > We do not contend that the Act cannot involve a "taking" or that the Fifth Amendment standard differs depending on which powers Congress invokes.
>
> *See also id.* at 14-15.

Since then the court and all the parties have proceeded on the basis that the fair and equitable standard of § 303(c)(1)(A) requires the "just compensation" mandated by the Fifth Amendment, neither less nor more. No one in these proceedings has argued to the contrary.

The Interest Claim

Under the Rail Act, as enacted in 1974, Pub. L. No. 93-236, §§ 206(d), 303(a), (b), 87 Stat. 985, 996, 1005-06, transferors of rail properties pursuant to the Final System Plan (FSP) were to be compensated with securities of Conrail and obligations of the United States Railway Association (USRA), with any "short-fall" to be recovered by an action in the Court of Claims under the Tucker Act, 28 U.S.C. § 1491, see *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 123-36, 148-56 (1974).

Appendix N

The Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, § 610(b), 90 Stat. 31, 104-05, amended the Rail Act so that payment was to be in "certificates of value", outlined in newly created § 306. The certificates of value were to be guaranteed by the Secretary of Transportation and to "constitute general obligations of the United States of America for the payment or redemption of which its full faith and credit are pledged", § 306(a). They were to be redeemed by USRA on December 31, 1987, or on such earlier date as USRA's Board of Directors and Finance Committee might jointly specify, § 306(c)(1). The redemption price of each certificate was to be its "base value" on the redemption date less the sum of the fair market value of Conrail securities attributable to such certificate, cash dividends thereon, and another item not here material, § 306(c)(2). The base value was to be, § 306(c)(4):

> the value obtained by (A) taking the net liquidation value, as determined by the special court, to which the transferor to whom such series of certificates of value is issued is entitled by virtue of transfers of rail properties, under section 303(b)(1) of this title to [Conrail] or a subsidiary thereof; (B) subtracting the value of other benefits provided under this Act, as determined by the special court; (C) adding such amount, if any, as the special court may determine shall be required after taking into consideration compensable unconstitutional erosion, if any, in the estate of a railroad in reorganization, of a railroad leased, operated, or controlled by such a railroad, which the special court finds to have occurred during any bankruptcy proceeding with respect to such railroad; (D) *adding interest from the transfer date to the redemption date to be compounded annually at a rate of 8 percent per annum;* and (E) dividing the resulting value by the number of certificates of value of such series distributed to such transferor. (Emphasis supplied.)

Appendix N

The Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, § 1167(b), 95 Stat. 357, 686, repealed the provision of § 306(c)(2) requiring deduction for the value of Conrail securities, since these were now all to be owned by the United States. See S. Rep. No. 139, 97th Cong., 1st Sess. 341, *reprinted in* 1981 U.S. Code Cong. & Ad. News 396, 629.

CNJ concedes that

> [a]t the time Section 306(c)(4) was enacted, early in 1976, the 8% rate of interest, compounded, was seemingly adequate.

CNJ Answer and Memorandum at 13 (Jan. 5, 1984) (footnote omitted). This concession is well-advised in light of the evidence that

> [t]en-year Treasury notes bearing 7⅞ percent and 8 percent respectively sold in May and August 1976 at or very near to face value (*see* Treasury Bulletin, May 1976 at V, August 1976 at V, 81; September 1976, at 72), and on March 31, 1976, the average yields of Treasury securities outstanding indicated a 7.7 percent return for securities maturing in 1987.* *Id.*, April 1976, at 89.

GPs Reply in Support of Proposed Final Judgment at 26 n.26 (Jan. 19, 1984). CNJ's claim is that what appeared to be a fair interest rate when the Rail Act was amended in 1976 has ceased to be so in light of the increase in such rates and that the allowance of only 8% interest, compounded annually, deprives it of the just compensation required by the Fifth Amendment for the delay in payment.

It is not disputed that when the Government takes property and defers payment, it must compensate the owner for the delay. In addition to the oft-quoted general statements in *United States* v. *Miller*, 317 U.S. 369, 373 (1943) (footnote omitted), that the compensation provided by the Fifth Amendment "means the full and perfect equivalent in money of the property taken", citing

Monongahela Navigation Co. v. *United States*, 148 U.S. 312, 326 (1893), and that "[t]he owner is to be put in as good a position pecuniarily as he would have occupied if his property had not been taken", 317 U.S. at 373 (footnote omitted), the Court said expressly in *Seaboard Air Line Railway* v. *United States*, 261 U.S. 299, 306 (1923):

> The requirement that "just compensation" shall be paid is comprehensive and includes all elements and no specific command to include interest is necessary when interest or its equivalent is a part of such compensation. Where the United States condemns and takes possession of land before ascertaining or paying compensation, the owner is not limited to the value of the property at the time of the taking; he is entitled to such addition as will produce the full equivalent of that value paid contemporaneously with the taking. Interest at a proper rate is a good measure by which to ascertain the amount to be added.

The Court has reaffirmed this very recently when it said in *Kirby Forest Industries* v. *United States*, 52 U.S.L.W. 4607, 4610 (May 21, 1984), that "if disbursement of the award is delayed, the owner is entitled to interest thereon sufficient to ensure that he is placed in as good a position pecuniarily as he would have occupied if the payment had coincided with the appropriation." See, to the same effect, *Phelphs* v. *United States*, 274 U.S. 341 (1927); *Shoshone Tribe* v. *United States*, 299 U.S. 476, 497 (1937); 3 Nichols, The Law of Eminent Domain § 8.63, at 8-293 (Sackman rev. 3d ed. 1981).

CNJ's claim is that although the 8% annually compounded rate was fair when Congress provided for the CVs in 1976, things did not turn out that way, and therefore the Fifth Amendment requires that corrective action must be taken now. At oral argument on May 16, 1984, counsel for CNJ stated that Treasury bonds with rates and maturities nearly corresponding to those of the CVs were selling around 86; the differential between this

figure and face value reflects the market's estimate how much 8% is less than a fair interest rate between May, 1984 and December 31, 1987.[3] Beyond this CNJ allegedly had suffered a large loss in the differential between 8% and market rates of interest in many of the eight years since the conveyance.

In recent years, as a result of the explosion of interest rates, determination of the rate of interest constitutionally required in various types of taking has received increased attention from courts of appeals and the Court of Claims. This issue was not faced by us in our initial decision sustaining the constitutionality of the Rail Act, *180 Day Appeals*, 384 F. Supp. 895 (1974), or by the Supreme Court in the *Regional Rail Reorganization Act Cases*, *supra*, 419 U.S. 102, since, as noted, the form of compensation then provided was different.

United States v. *Blankinship*, 543 F.2d 1272 (9 Cir. 1976), involved two takings by the United States in Oregon pursuant to the Declaration of Taking Act, 40 U.S.C. § 258a. That Act provides that title shall vest in the United States upon the filing in an appropriate court of a declaration of taking and deposit of the estimated compensation. When compensation is ultimately ascertained, the judgment

> shall include, as part of the just compensation awarded, interest at the rate of 6 per centum per annum on the amount finally awarded as the value of the property as of the date of taking, from said date to the date of payment; but interest shall not be allowed on so much thereof as shall have been paid into the court.

After reviewing Supreme Court decisions, including the *Miller* and *Seaboard Air Line Railway* cases cited above, the court of appeals concluded, in agreement with the district court, that "the Fifth Amendment under certain circumstances does require the use of a rate of interest in excess of 6 percent", 543 F.2d at 1274.[4] However, it disapproved the method by which the district court

had computed rates of 8.5% for one parcel and of 8% for another. These had been reached on the basis of evidence pertaining to the commercial "prime rate", the rates applicable to three- and six-months certificates of deposit issued by certain Oregon banks, and ninety- and 180-day Treasury bills. The Ninth Circuit noted that this mix included "obligations not as riskless as those of the Treasury"; it believed that "the trial court should have focused more on that type of marketable public debt security which constitutes a direct obligation of the United States Treasury having a duration approximately the period during which the deficiency was unpaid." 543 F.2d at 1276. That, as we have seen, is exactly what Congress did with respect to the CVs; indeed, it provided for the annual compounding of interest, a factor with which the Ninth Circuit did not expressly deal. So viewed, the case would be an authority against CNJ, not for it. Operating somewhat against this, however, is the court's statement, *id.* at 1277:

> We also acknowledge that the marketability of a claim against the United States for a deficiency under the Declaration of Taking Act is considerably less than that of a marketable public debt security of the United States. Some allowance for this feature by the trier of fact is not unreasonable.

In fact the marketability of the condemnee's deficiency claim against the United States would seem to have been nearly nil, since no one could know what the amount of the claim would be or when it would become due. In the former respect but not in the latter, the case is like CNJ's.

A few months later the Court of Claims decided *Pitcairn* v. *United States*, 547 F.2d 1106 (Ct. Cl. 1976) (en banc) (per curiam), *cert. denied*, 434 U.S. 1051 (1978). This involved claims of an inventor for patent infringement by the United States, 28 U.S.C. § 1498, and the pertinent question was the

fixing of appropriate rates of "delay compensation" on the royalty payments which it was determined the Government should have made over a long period from 1947 to 1975. In contrast to *Blankinship*, there was no applicable statute. A majority held that it was reasonable to divide the delay period into several periods and to fix rates rising from a low of 4% for 1947-1955 to a high of 7½% for 1971-1975. 547 F.2d at 1121. This was based on "evidence of record relating to the trends indicated by Moody's Composite Index of Yields on Long Term Corporate Bonds". *Id.* The court rejected the Government's claim that a more appropriate reference point was "the average annual yields of a series of hypothetical long term government bonds, in effect, the cost to the Government of borrowing money", as running counter to "the established rule of eminent domain that damages should be determined by what the condemnee has lost, not what the taker has gained." *Id.* at 1122. This reasoning overlooked the peculiar relevance of the yields on government obligations, which is what the claimant is given—however correct the actual decision may have been with respect to the "hypothetical" long-term bonds proffered as evidence. The reason why government bond yields are of peculiar relevance, as pointed out by Judge Sneed in *Blankinship*, 543 F.2d at 1276, and by Judge Skelton, concurring in part and dissenting in part in *Pitcairn*, 547 F.2d at 1128-30, is that they are free of the risk of default.

In *Tektronix, Inc.* v. *United States*, 552 F.2d 343, 352 (Ct. Cl. 1977) (en banc), *cert. denied*, 439 U.S. 1048 (1978), the court directed that the *Pitcairn* rates be applied to all future just compensation cases "unless and until it is affirmatively demonstrated that under the theory of the *Pitcairn* opinion the rate for years after 1975 should differ from the 7½% rate set for 1971-75." Consistently with his opinion in *Pitcairn*, Judge Skelton, concurring in part and dissenting in part, would have remanded

> this part of the case to the trial judge with instructions to fix the interest rate for the periods in question according to

> the yield of Government obligations with duration approximating the periods of time from the date of each taking until paid, and that once the interest rate was determined for each taking, it would remain constant until paid.

Id. at 356.

In *Miller* v. *United States*, 620 F.2d 812 (Ct. Cl. 1980), the Court of Claims was confronted with a case where, in contrast to the *Pitcairn* and *Tektronix* cases, Congress had provided, in the Act of Oct. 2, 1968, Pub. L. No. 90-545, § 3(B)(2), 82 Stat. 931, 932, 16 U.S.C. § 79c(b)(2), relating to the expansion of Redwood National Park, for a 6% rate of interest from the date of taking to that of judgment. The trial judge applied this, relying on the fact that at the time of the taking, October 2, 1968, "6 percent was in excess of the rate of interest paid by the United States Treasury on all governmental obligations regardless of term." 620 F.2d at 838. The court held this to be error, citing a number of cases, including the three just discussed, as showing "that the courts have looked to the interest rates prevailing in the years between the date of taking and the date of payment." *Id.* The court thought "[i]t would be possible for the courts to fix the interest rates received by any condemnee in the same manner as defendant suggests, *i.e.*, by reference to the prevailing rate of interest at the time of taking", and also noted that "[a] superficial reading of Pub. L. No. 90-545 might indicate that Congress intended to establish a different treatment for redwood park landowners." *Id.* However, it perceived "a strong judicial policy in favor of the establishment of a uniform rate of interest applicable to condemnation cases in order to avoid discrimination among litigants" and therefore decided to "construe Pub. L. No. 90-545 as establishing the same manner of treatment for redwood park condemnees as that for other condemnees." *Id.* at 838-39. It went on to say, *id.* at 839 (footnote omitted):

> The keystone to defendant's argument in favor of limiting the rate of interest to 6 percent is its analogy of plaintiffs' situation to a person who has bought a Government obligation in 1968 at the then current interest rate of 6 percent. This analogy has several flaws. No reasonable investor would purchase an obligation with both an uncertain date of maturity and an uncertain amount of principal payable at maturity. Plaintiffs had their business property involuntarily converted into an extremely illiquid claim against the United States. Since plaintiffs' options for other investments were effectively cut off, just compensation in this case should include payments for delay of compensation measured by the interest rates prevailing between the taking and payment dates. The Government, not the unwilling condemnee, should be the one to bear the risk of any fluctuations in interest rates.

The court applied the *Pitcairn* rates through 1975 but thereafter, taking judicial notice of Moody's rates for long-term Aaa corporate bonds, applied a rate of 8½% for the years 1976-1979 and of 12% for the year 1980 to the date of payment, although stating that the 12% rate would not be regarded as a precedent. *Id.* at 840. Apparently these rates were, as in *Pitcairn*, simple interest. The Court of Claims reaffirmed this approach in *Georgia-Pacific Corp.* v. *United States*, 640 F.2d 328, 365-67 (1980) (per curiam)—another Redwood National Park taking.

In addition to the criticism of use of long-term corporate bond yields made by Judge Sneed in *Blankinship, supra*, 543 F.2d at 1276, namely, that they do not reflect the risk-free character of government obligations, which the condemnee in effect held, resort to *any* varying long-term bond yields to measure "delay compensation" is subject to a more fundamental criticism if, as here, such yields climb from period to period.[5] This is that it would have been impossible for CNJ to shift from year to year from long term bonds with lower to higher rates as bond yields

increased without incurring substantial capital losses.[6] Rather than pressing these lines of attack, the Government Parties (GPs) rely on the fact, not disputed by CNJ, that use of the *Pitcairn-Tektronix-Miller* approach of the Court of Claims would not produce delay compensation for CNJ significantly higher than the 8% compound interest provided for in § 306(c)(4)(D) unless it were to be supplemented by incorporating an element which the Court of Claims has declined to add, namely, compound rather than simple interest. In other words, acceptance of CNJ's proposal, rather than producing the uniformity which the Court of Claims deemed desirable, would place CNJ in a preferred class.

While eagerly embracing the Court of Claims' approach in other respects, CNJ says that in using simple rather than compound interest the Court of Claims has been wrong. It points out that interest payments on bonds are generally made semiannually, thereby enabling the holder to earn interest on interest. For authority CNJ relies on *United States* v. *429.59 Acres of Land*, 612 F.2d 459, 464-65 (9 Cir. 1980). Compensation for a taking there was fixed by a Commission appointed under Fed. R. Civ. P. 71A(h), whose factual findings enjoyed the protection of the "unless clearly erroneous" rule, see Fed. R. Civ. P. 53(e)(2). The Commission found the appropriate interest rate for a period between May, 1971 and the time of its report to be 6.635% on the basis of average yields on a composite of four securities—six-month Treasury bills, four- to six-month prime commercial paper, ninety-day prime bankers acceptances, and six-month bank certificates of deposit. It then compounded that rate annually to arrive at a figure of 7.4% per annum. 612 F.2d at 465. The court held that the Commission had not clearly erred either in not considering government obligations with maturities greater than 180 days, as it had suggested in *Blankinship, supra*, 543 F.2d at 1274, or in compounding interest. With respect to the latter it said, 612 F.2d at 465:

> Compounding of interest is appropriate to compensate the landowners for the loss of use of the interest that the deficiency award would have been producing for them during the interim.

Contra, United States v. *97.19 Acres of Land*, 511 F. Supp. 565, 570 (D. Md. 1981) (following Court of Claims' use of long-term corporate Aaa bond interest but declining to compound on the basis that "the Court of Claims formula adequately compensates a property owner for deprivation of the deficiency amount"). The most that CNJ can extract from *429.59 Acres, supra*, is that compounding of interest is not improper *when the interest yield has been computed on an appropriate basis.* We consider that, in the usual case, this would be either the yield on government bonds purchased at the time of the taking and maturing at the date of payment, as suggested by Judge Sneed for a majority in *Blankinship* and by Judge Skelton dissenting in *Tektronix*, with such adjustment, if any, as may be proper because of illiquidity, or yields on short-term government obligations.[7]

The first of these alternatives is what CNJ already has under § 306(c)(4)(D), subject only to the problem of marketability noted in *Blankinship*. We decline to consider the second since we do not subscribe to CNJ's thesis that, under the unique circumstances of this case, we can properly set aside the carefully considered determination of Congress, conceded by CNJ to have been reasonable at the time, that interest of 8% compounded annually constituted just compensation for the delay necessarily incident to the computation of the NLV and CMV of the railroads' properties.[8]

In saying this we recognize the famous statement in *Monongahela Navigation Co.* v. *United States*, supra, 148 U.S. at 327, that

> [t]he legislature may determine what private property is needed for public purposes—that is a question of a political and legislative character; but when the taking has been

> ordered, then the question of compensation is judicial. It does not rest with the public, taking the property, through Congress or the legislature, its representative, to say what compensation shall be paid, or even what shall be the rule of compensation. The Constitution has declared that just compensation shall be paid, and the ascertainment of that is a judicial inquiry.

Accord, United States v. *New River Collieries Co.*, 262 U.S. 341, 343-44 (1923). However, it does not follow from these general statements that when delay compensation is an integral part of a broad Congressional plan to preserve essential railroad service in the Northeast and to enable the bankrupt railroads in that region to receive billions of dollars from the Federal Treasury in compensation for properties whose operations were grinding to a halt, we are bound to treat the decision of Congress as if it did not exist. The decision was rational not only in the sense that 8% compound interest on a government obligation with a maturity of eleven years and eight months was fair, as it concededly was, but in the broader sense that CNJ has adduced no evidence that anyone was then aware that interest rates would climb precipitously.[9] Moreover, the decision clearly was a considered one. Congress did not adopt the time-honored 6% simple interest provision of the Declaration of Taking Act, 40 U.S.C. § 258a; instead it provided a much more generous 8% compound interest rate. See S. Conf. Rep. No. 595, 94th Cong., 2d Sess. 140, *reprinted in* 1976 U.S. Code Cong. & Ad. News 148, 155; H.R. Conf. Rep. No. 781, 94th Cong., 2d Sess. 140 (1976). When the New York Court of Appeals upheld the application of general statutory interest rates of 6% simple interest in condemnation cases, *County of Nassau* v. *Eveandra Enterprises, Inc.*, 42 N.Y.2d 849, 850, 397 N.Y.S.2d 627, 628 (1977), saying "[s]o long as the statutory rate constitutes a judicially acceptable, fair return for the deprivation of the use of that property or the money equivalent of that use, either or in combination, the statutory rate should be considered proper",

the Supreme Court dismissed the condemnee's appeal "for want of substantial federal question." 434 U.S. 804 (1977).[10] This seems to us to apply *a fortiori* to a recently enacted statute designed to deal with a particular complex situation.[11]

As noted, we need not and do not go so far as to say that whenever Congress provides a rate of interest for delay compensation that is reasonable at the time of enactment, that rate necessarily remains so. This is not the ordinary case where government, for a public purpose, deprives a citizen of property which he would have preferred to keep for his own use. Continued operation was the last thing the railroads wanted; it was something they had neither the desire nor the ability to perform. See *CMV Opinion*, *supra*, 445 F. Supp. at 1017 (The railroads "have no desire to be put in a financial position that will enable them to build another railroad; they want to exit from the railroad business, not enter it."). The Rail Act, as we said in our first opinion, "was a Congressional response to the threat to the national welfare posed by the bankruptcy of the railroads in the northeastern United States .... These bankruptcies differed from earlier railroad insolvencies in an essential respect. Whereas earlier insolvencies had typically been caused by inability to meet fixed charges or debt maturities, the causes of [the] railroad bankruptcies [of the late 1960's and early 1970's]in the northeastern region went much deeper; the roads were unable to pay taxes and operating expenses, even with substantial undermaintenance of plant which, in turn, led to revenue losses and increased expense, particularly for freight car hire." 384 F. Supp. at 902-03. Recognizing this, Congress made numerous provisions in the Rail Act, see *id.* at 909-10, granting financial aid to enable the railroads to keep alive between the date of enactment, January 2, 1974, and the date of conveyance, which turned out to be April 1, 1976. The desperate financial condition of these railroads is further detailed in our *CUE Opinion*, 439 F. Supp. 1351 (1977), and in our *Rail Use Opinion*, 531 F. Supp. 1191, 1215-17 (1981). Indeed the whole basis for the railroads'

claim of compensable unconstitutional erosion was that the Rail Act postponed the dates when they would otherwise have ceased operation.

CNJ was not immune from the conditions affecting the other northeastern railroads. Indeed, it had been the first to enter bankruptcy, on March 22, 1967, and, for reasons outlined in our *CUE Opinion*,[12] its situation in some respects was worse than that of other carriers. CNJ would doubtless respond that it was better off than other carriers in having a ready and willing purchaser, the State of New Jersey. However, as is implicit in our *CNJ Opinion*, 571 F. Supp. 1269, 1280-84 (1983), see also *Rail Use Opinion*, *supra*, 531 F. Supp. at 1382, the State would have taken full advantage of CNJ's lack of bargaining power. Indeed, CNJ's bargaining position with the State would have been peculiarly weak since the State was supplying the oxygen (in the form of subsidies) on which CNJ's life depended.[13]

Beneficial as the original Rail Act was to the affected carriers, the 1976 amendments made it even more so. One notable instance was the creation of the CVs as a means of payment in substitution for the limited amount of USRA obligations and Conrail securities provided for and the suit in the Court of Claims permitted by the 1974 Act for any excess of the value of the conveyed properties over the value of the allotted USRA obligations and Conrail stock. It was altogether legitimate for Congress, as part of such a comprehensive scheme, to fix the 8% compound interest which concededly appeared to be fair in 1976 as the amount of interest on the CVs. CNJ's plea for uniformity—more accurately for a preferred position, as we have shown—rings hollow in the context of the Rail Act, a unique piece of legislation designed to cope with a national emergency of unparalleled magnitude. If interest rates had declined, CNJ would hardly have agreed that the 8% compound rate made its compensation "more fair and equitable than is required as a constitutional minimum" under § 303(c)(1)(B). In this situation, unlike cases arising under the Declaration of Taking Act, 40

U.S.C. 258a, we see nothing in the just compensation clause that forbids us to accord appropriate respect to the fair and considered determination of Congress.[14]

The Newark Bay Bridge

The Newark Bay Bridge (Bridge) is a structure built by CNJ under authorization from Congress in 1919, Act of Aug. 8, 1919, ch. 42, 41 Stat. 277.[15] A subsequent statute extended the period during which CNJ was to commence and complete construction, Act of Feb. 21, 1921, ch. 47, 41 Stat. 1099. The authorizing statute provided that the Bridge was subject to the Bridge Act of 1906 hereafter discussed. The Bridge spans lower Newark Bay for some 1.4 miles between Elizabethport and Bayonne, New Jersey. The Final System Plan (FSP) provided for the conveyance to Conrail of CNJ's tracks immediately to the west and east of the Bridge but left the Bridge itself with CNJ.[16] As will be detailed below, the Coast Guard has decreed the Bridge to be a hazard to navigation and has ordered its removal. Since the Bridge is no longer used for rail purposes, the costs of this, estimated to be some $14,000,000, will fall on CNJ, whereas if it had continued to be used for rail purposes, most if not all the cost would have been borne by the United States. CNJ contends that this removal cost constitutes "severance damage" for which it is entitled to just compensation under the Fifth Amendment. In order to evaluate the claim it is necessary to review the applicable federal bridge legislation and the history of this long-standing problem.

The right to erect or maintain a bridge across any navigable waters of the United States or to build anything in such waters, has always been "subject to the paramount right of navigation." *Union Bridge Co.* v. *United States*, 204 U.S. 364, 398 (1907).[17] Section 4 of the Bridge Act of 1906, ch. 1130, 34 Stat. 84, 85, 33 U.S.C. § 494, states:

> No bridge erected or maintained under the provisions of [this Act] . . . shall at any time unreasonably obstruct the free navigation of the waters over which it is constructed . . . .

The Government (Secretary of Transportation), "after giving the parties interested reasonable opportunity to be heard," may require the bridge owner to "alter the [bridge] as to render navigation through or under it reasonably free, easy, and unobstructed . . . . [A]ll such alterations shall be made and all such obstructions shall be removed at the expense of the persons owning or operating [the] bridge." *Id.* Section 18 of the Rivers and Harbors Act of 1899, ch. 425, 30 Stat. 1121, 1153-54, 30 U.S.C. § 502, provides criminal penalties for the willful failure of a bridge owner to comply with a lawful order "to alter the [bridge] as to render navigation through or under it reasonably free, easy, and unobstructed." Accordingly, until Congress enacted the Truman-Hobbs Act in 1940, "the owner of a bridge across a navigable stream was not entitled to any compensation for the alteration or removal of the bridge as a result of navigation needs." *Southern Railway Co.* v. *Tennessee Valley Authority*, 294 F.2d 491, 493 (5 Cir. 1961).

On June 21, 1940, Congress enacted the Truman-Hobbs Act, ch. 409, 54 Stat. 497, 33 U.S.C. §§ 511 *et seq.*, in order to ease the financial burdens that the Bridge Act of 1906 imposed on railroad bridge owners. Applicable only to bridges "over navigable waters of the United States . . . used and operated for the purpose of carrying railroad traffic, or both railroad and highway traffic," § 511, the Act covers Government-ordered "alteration[s]", defined as including "changes of any kind, reconstruction, or removal in whole or in part", *id.*; see § 516, and "relocation[s]", not defined in § 523. Pursuant to § 516, the cost of any alteration or relocation project is to be apportioned between the Government and the bridge owner as follows:

> *The bridge owner shall bear such part of the cost as is attributable to the direct and special benefits which will accrue to the bridge owner as a result of the alteration,* including the expectable savings in repair or maintenance costs; and that part of the cost attributable to the requirements of traffic by railroad or highway, or both, including any expenditure for increased carrying capacity of the bridge, and including such proportion of the actual capital cost of the old bridge or of such part of the old bridge as may be altered or changed or rebuilt, as the used service life of the whole or a part, as the case may be, bears to the total estimated service life of the whole or a part . . . . *The United States shall bear the balance of the cost, including that part attributable to the necessities of navigation* . . . . (Emphasis supplied).

In other words, the Act "would impose on the Government the total cost incurred in the interest of navigation, with suitable apportionment of the cost to the railroad covering special improvements to the benefit of the railroad, the remaining useful life of the facility, and the like." *Seaboard Coast Line Railroad* v. *Coleman*, 562 F.2d 1008, 1010 (5 Cir. 1977).

An order for "alteration" or "relocation" may be issued by the Secretary of Transportation (or his delegate, currently the Commandant of the Coast Guard) on making necessary findings and after complying with certain procedural requirements. See § 513. Any such order of the Secretary, however, must give "due regard . . . for the necessities of rail or highway traffic thereover." *Id.* Orders issued under §§ 516 and 523 are subject to review by the United States Court of Appeals for the circuit where the bridge is located. See § 520.

The Bridge's location rendered it an obstruction to navigation, which became more serious with the expansion of shipping in Newark Bay. Numerous accidents had occurred; between 1951 and 1970, the Coast Guard recorded twenty-one collisions of

vessels with the Bridge. A most serious collision in 1966 had "permanently damaged the easterly drawspan of the northern bridge," which was later removed. Exhibit GPS-Bd (Feb. 1982)-20, at 49-50.

In 1969 the Coast Guard, responding to a request from the American Institute of Merchant Shipping, began to investigate whether the Bridge was a navigational hazard. The preliminary investigation was conducted in preparation for proceedings under the Truman-Hobbs Act. The Coast Guard wrote the CNJ on September 5, 1969, asking about the latter's "long range plans" for the Bridge, referring CNJ to the Truman-Hobbs Act and explaining that under the statute, "if the bridge is determined by the Government to be obstructive and either alteration or replacement is directed, the federal government assists in the funding." Exhibit GPS-CNJ Bridge (Mar. 1984)-4. CNJ responded on October 29, stating that it had reviewed the procedures of the Truman-Hobbs Act and notifying the Coast Guard that the Bridge "is absolutely necessary [to CNJ's operations] for many years to come." Exhibit GPC-CNJ Bridge (Mar. 1984)-5. The Coast Guard's preliminary investigation concluded "that the bridge might be an unreasonable obstruction to navigation" and recommended instituting formal hearings pursuant to § 7 of the Truman-Hobbs Act, 33 U.S.C. § 513. See Exhibit GPS-CNJ Bridge (Mar. 1984)-6, at 1.

In preparation for the hearing held in April, 1970, several Coast Guard officials met with their counterparts at CNJ on February 25, 1970. The Coast Guard explained the provisions of the Truman-Hobbs Act and discussed with CNJ the possible methods for improving clearances for ships passing under the Bridge. See Exhibit GPS-CNJ Bridge (Mar. 1984)-7.

CNJ did not attend the April 1970 hearing, choosing instead to submit a letter from its chief engineer. That letter stated that "CNJ is in no position to assume any portion of the cost" of any alterations of the Bridge, and implied that CNJ intended to use the Bridge "in the foreseeable future". Exhibit GPS-BD (Feb.

1982)-20, at 123. The Coast Guard's Report on the Obstructive Character of the Central Railroad of New Jersey Bridge Across Newark Bay, dated October 24, 1972, concluded that

> the bridge, as it stands, is an unreasonable obstruction to navigation and that there is a need and justification for its replacement. It is recommended that [CNJ] be ordered to alter its railroad bridge . . . by replacing the existing bridge with a new bridge providing the required clearances, and to submit general plans and specifications for replacing the existing bridge . . . . The estimated cost is $14,267,700 of which amount the United States would pay $13,484,300 and [CNJ] $777,400 on the basis of apportionment of cost under Section 6 of the Truman-Hobbs Act.

Exhibit GPS-CNJ Bridge (Mar. 1984)-8, at 1. The Report also estimated the total cost of a complete removal of the Bridge and rerouting of CNJ's traffic to the Penn Central-Lehigh Valley Bridge (PC-LV Bridge), see *supra* note 16, to be about $10,000,000. *Id.* at 13-14.

In January, 1971, Mr. Timpany, who had become the CNJ Trustee, reexamined CNJ's need for a separate bridge over Newark Bay. He concluded that CNJ's traffic should be rerouted to the PC-LV Bridge; this would permit removal of the Bridge. See Timpany (S) (Feb. 1984) at 2. Negotiations then began with the Port of New York Authority (Port Authority), PC and LV and the Coast Guard, the inconclusive result of which will be discussed below.

Apart from the negotiations involving the Port Authority and PC and LV, the Coast Guard continued to try to resolve the Bridge problem with CNJ. On November 30, 1972, the Coast Guard notified CNJ that, pursuant to § 3 of the Truman-Hobbs Act, "it has been determined that [the Bridge] is considered to be

an unreasonable obstruction to navigation of the navigable channel." The letter outlined the "proposed plan of alteration" and stated that "[a] preliminary apportionment of [the estimated project cost of $14,261,700] has been prepared . . . , arriving at a tentative allocation of $777,400 to [CNJ] and $13,484,300 to the United States." The Coast Guard also explained that the apportionment of costs was based on an "exemplification of the principles of Section 6 of the Truman-Hobbs Act," a copy of which was enclosed, see Exhibit GPS-CNJ Bridge (Mar. 1984)-1. Lastly, the Coast Guard noted that "[a]s an alternative to the foregoing plan consideration should be given to rerouting [CNJ's] rail traffic over the existing [PC-LV Bridge]," an alternative that "could be accomplished by an agreement under the provision of Section 13 of the Truman-Hobbs Act." Exhibit GPS-CNJ Bridge (Mar. 1984)-10.

CNJ responded on January 25, 1973, stating "[a]t the outset . . . that in its present condition, CNJ has no funds available for participation in a project of the magnitude set forth in [the Coast Guard's Report], nor does it have access to any funds which would permit it to so participate." CNJ advised that its "present condition [is] that all interests would be best served if CNJ's rail traffic which presently traverses this bridge were transferred to the [PC-LV Bridge]." CNJ summarized its position as follows:

> [W]e are in favor of rerouting of CNJ's traffic and the elimination of the obstruction to navigation provided that:
>
> (1) no expense thereof be assessed against CNJ;
>
> (2) CNJ would be permitted to sell the [Bridge], presently valued in excess of $4,200,000,
>
> (3) CNJ would be reimbursed for any increased operating expenses resulting from the use of the [PC-LV Bridge],

> (4) CNJ would also be reimbursed for any construction cost involved in making any necessary connections in order to operate over the [PC-LV Bridge].

Timpany (S) (Feb. 1984) Exh. 13.

The Coast Guard again wrote to CNJ on April 16, 1973, requesting additional information on which to calculate the costs of removing the Bridge and rerouting CNJ's rail traffic; the Coast Guard reiterated:

> The costs of relocation of new construction . . . come under Section 13 [of the Truman-Hobbs Act] which provides that they should be apportioned between the bridge owner [CNJ] and the United States as provided in Section 6 (33 U.S.C. 516) of the Act.

Exhibit GPS-CNJ Bridge (Mar. 1984)-11.

CNJ responded on June 20, 1973, and repeated its position:

> CNJ believes that it is in the best interest of all parties involved to eliminate [the Bridge], rather than replacing it with a wider span. However, [CNJ] must again emphasize . . . [that] [t]he completion of the project must depend solely on funds other than those of CNJ, and CNJ must be totally reimbursed for its increased operating expenses, including annual usage payments to the [PC and LV].

Exhibit GPS-CNJ Bridge (Mar. 1984)-12.

Another aspect of the Coast Guard's plan to remove or alter the Bridge concerned what to do with the existing passenger service. Ultimately, the administration of New Jersey's Governor Byrne concluded that such service could be replaced with bus service. Initially, Governor Cahill's administration, which had taken office in January, 1970, supported the proposal to shift CNJ's freight traffic to the PC-LV Bridge and indicated that

"[a]lternative routes [for passenger service] may be completely acceptable to the [New Jersey] Department of Transportation both from a service and subsidy viewpoint." Timpany (S) (Feb. 1984) Exh. 8 (Letter from Robert J. Bussolt, Deputy Attorney General, New Jersey, to Robert L. Oswald, Secretary, ICC (Sept. 19, 1972)). Governor Cahill's loss in the June 1973 primary election prevented any action in the fall of 1973. See Timpany (S) (Feb. 1984) at 12; see also *CUE Opinion*, *supra*, 439 F. Supp. at 1382 & n.56.

On July 12, 1974, the new Commissioner of Transportation, Alan Sagner, met with the Coast Guard and indicated that he wished to delay any decision on the commuter service until the fall of that year "to allow time for the completion of a transportation study." Exhibit GPS-CNJ Bridge (Mar. 1984)-16. Commissioner Sagner continued to withhold a decision about the commuter service across the Bridge until April, 1975, when he notified the Coast Guard of the State's conclusion "that the bridge should not be demolished". Timpany (S) (Feb. 1984) Exh. 18. Three months later, however, in a meeting on July 11, 1975 with the Coast Guard and Port Authority, Commissioner Sagner agreed that the Bridge could be removed and bus service substituted for the commuter rail service. See Exhibit GPS-CNJ Bridge (Mar. 1984)-19. The parties also discussed the factor that "an abandonment of services across the CNJ bridge could possibly preempt employment of the Truman-Hobbs Act to solve the navigation problems caused by this bridge." *Id.* Thus, Sagner hoped that rail service over the Bridge would be maintained until action could be taken under the Truman-Hobbs Act.

Six months later, on January 27, 1976, in another meeting among the Coast Guard, the New Jersey Department of Transportation, the Port Authority and the FRA, Commissioner Sagner's Deputy, Stangl, reiterated that New Jersey was prepared "to provide alternate transportation systems for the remaining passenger rail use of the CNJ bridge and intends to accommodate the removal of the bridge." Stangl also stated that the "State

believes the Order to Alter (O/A) should be issued." Exhibit GPS-CNJ Bridge (Mar. 1984)-20. The participants recognized:

> [T]he total project cost [of removal] is some 12 million dollars. CNJ is still the legal owner of the bridge and under the law subject for their portion of the removal cost.

Moreover, they noted that action under the Truman-Hobbs Act might not be possible if an Order to Alter was not issued before the April 1, 1976 date of the start of Conrail's operations. See *id.*

In a meeting with the Coast Guard on February 13, 1976, Timpany stated that CNJ's response to an "Order to Alter" under the Truman-Hobbs Act would simply be that "we are broke". Exhibit GPS-CNJ Bridge (Mar. 1984)-21. He also indicated that CNJ considered the Bridge to be a $21 million asset and as the minutes of the meeting recite:

> At the conclusion of the meeting, it was evident that CNJ's position was that [it] wanted the bridge removed, but [it] also would be paid something for losing the bridge, which [it] considered an asset.

Id.

CNJ continued to provide passenger and limited freight service over the Bridge until April 1, 1976. At that time, pursuant to the FSP, CNJ's rail line in Elizabethport up to the beginning of the Bridge structure and CNJ's line in Bayonne within one half mile of the Bridge were taken by Conrail. The Bridge itself remained with CNJ, subject to an easement to Conrail for so long as Conrail conducted passenger operations over it, see Timpany (S) (Feb. 1984) Exh. 19; *supra* note 16. Pursuant to a subsidy arrangement with the State of New Jersey, Conrail operated passenger service over the Bridge until August 1, 1978.

On May 19, 1977, at which time the Bridge was serving passenger traffic, the Coast Guard, pursuant to the Truman-Hobbs Act,

issued an "Order to Alter" to CNJ. The Order provided in pertinent part:

> [The Coast Guard] has determined that this bridge is an unreasonable obstruction to navigation;
>
> [The Coast Guard] directs The Central Railroad of New Jersey to alter this bridge by constructing one new movable span on the same general alignment as the existing bridge. . . . If desired, the Coast Guard will consider a relocation of this facility in order to facilitate a removal of the bridge from the waterway.

Timpany (S) (Feb. 1984) Exh. 20.

Once the Coast Guard learned of the decision to discontinue rail service over the Bridge, it advised CNJ that "[a]t such time as rail service terminates, the [Bridge] will . . . not be a 'bridge' as that term is defined in the Truman-Hobbs Act. Accordingly, that Act will no longer be applicable." Instead, the Coast Guard would be forced to proceed under the Bridge Act of 1906, whereby the owner bears the entire expense of removal. The Coast Guard "reaffirm[ed] the determination made in 1972 that [the Bridge] is an unreasonable obstruction to free navigation" and informed CNJ that it has "determined that [the Bridge] should be removed when the present rail commuter service ceases." Thus, the Coast Guard notified CNJ of its "intention to issue an order for the removal of the bridge . . . under the authority of Section 4 of the Bridge Act of 1906, 33 U.S.C. 494." CNJ was given thirty days to respond to the proposed removal order. See Timpany (S) (Feb. 1984) Exh. 21.

CNJ did not respond. Instead, in July, 1978, it filed suit in the District Court for New Jersey seeking to enjoin the Coast Guard from proceeding under the Bridge Act of 1906. This was settled by an agreement dated June 11, 1979, supplemented by an agreement dated September 14, 1979. The pertinent provisions of the settlement were:

1) CNJ acknowledged that it was the owner of the Bridge within the meaning of the Bridge Act;

2) CNJ agreed that it would forego all further proceedings directed to review the Coast Guard's determination that the Bridge should be removed;

3) The suit in the District Court was to be dismissed without prejudice, and CNJ released any claim against the United States for inverse condemnation but expressly reserved its claim for severance damages;

4) The United States would remove the Bridge, using its best efforts to minimize expense, which included applying all salvage proceeds against such removal costs;

5) CNJ would recognize a claim by the United States against its estate for costs incurred in removing the Bridge, to be realized solely out of the proceeds CNJ would obtain in its valuation case, the claim to accrue interest at a compound annual interest rate of 8%.

Under CNJ's reorganization plan, which was approved by the District Court for New Jersey, *In re Central Railroad of New Jersey,* 473 F. Supp. 225 (D.N.J. 1979), CJI issued Series D 8% Contingent Notes to evidence the claim of the United States described above.

As indicated at the outset, CNJ's claim is that the failure of the FSP to provide for a taking of the Bridge, although taking the tracks adjacent on either side, inflicted severance damage in the amount of any sum which CNJ may be required to pay for removal of the Bridge.

The Supreme Court has defined severance damage as follows:

> If only a portion of a single tract is taken the owner's compensation for that taking includes any element of value arising out of the relation of the part taken to the

> entire tract. Such damages is often, though somewhat loosely, spoken of as severance damages.

United States v. *Miller*, 317 U.S. 369, 376 (1943) (footnote omitted). It had earlier stated in *Bauman* v. *Ross*, 167 U.S. 548, 574 (1897), that "[w]hen the part [of a land parcel] is left in such shape or condition, as to be in itself of less value than before, the owner is entitled to additional damages on that account."

Lower courts have offered variations on this theme. In *Miller* v. *United States, supra*, 620 F.2d at 828, the court stated:

> Severance damage, by its very nature, arises only on the taking of a portion of the owner's property and is directed at the diminution in value of the remaining portion not taken.

See *Coast Indian Community* v. *United States*, 550 F.2d 639 (Ct. Cl. 1977) (per curiam) ("Severance damage has been legally defined as the deterioration in value of the owner's remaining property caused by the transfer of property rights to a part of the land.") The court observed in *United States* v. *101.88 Acres of Land*, 616 F.2d 762, 767 (5 Cir. 1980), that "[i]n a partial taking case . . . the government impliedly agrees . . . to pay for damages to the landowner's remaining land proximately caused by the taking itself, and by the use of the land taken." See also Jahr, Law of Eminent Domain—Valuation and Proceeds § 104, at 141 (1957); 4A Nichols, *supra*, § 14.01[3], at 14-38 to 14-39; 1 Orgel, Valuation under the Law of Eminent Domain § 53, at 252 (2d ed. 1953).

CNJ's case does not fall comfortably within the concept of severance damage as thus defined. The taking of the tracks east and west of the Bridge did not prevent use of the Bridge for rail service as a tearing up of the tracks would have done; indeed Conrail maintained passenger service over the Bridge under a subsidy arrangement with New Jersey for more than two years. The Bridge had long ceased to have value for rail use. It likewise

had no value for nonrail use as that concept is normally applied, since the cost of removal considerably exceeded the scrap value.[18] CNJ's claim must be rather that the FSP decreased the likelihood of continued rail service over the Bridge and thus put removal costs under the regime of the Bridge Act for bridges not in rail service (owner pays all) rather than under the regime of the Truman-Hobbs Act for bridges in rail service (United States pays substantial portion), thereby transforming the value of the Bridge from zero to a large negative amount. However, CNJ was unable to continue operation over the Bridge without state subsidy, and any decreased likelihood of continued operation resulted not so much from the taking of the adjacent CNJ tracks as much as from the concentration in Conrail of the taken portions of CNJ and also of PC and LV, see *supra* note 16, thereby ending whatever small purpose the Bridge had served for freight traffic. It would go beyond any authority cited by CNJ[19] or known to us to hold that this came within the traditional concept of severance damage.

Although we could end our analysis at this point, the problem here presented is novel and we thus think it best to discuss the three principal arguments advanced by CNJ why it should be relieved of the bulk of the removal costs, without necessarily agreeing that any of them, if made out, would support an award for severance damage.

The first, insofar as we can understand it, is that if the Coast Guard had proceeded more speedily, the Bridge would have been altered or removed while it was still in rail service, with the Government bearing almost all the costs under the Truman-Hobbs Act. If CNJ suffered any injury from the Coast Guard's delay, the injury was not from any taking or failure to take under the Rail Act. In fact our narrative of the events shows that responsibility for delay rests rather more in CNJ than in the Coast Guard. If CNJ had reacted favorably to the Coast Guard's seemingly fair alteration Proposal of November 30, 1972, it would not have had the problem now confronting it.

Instead, whether through necessity, obstinacy, or as a bargaining tactic, CNJ refused to accept responsibility for any part of the cost and even insisted on being paid millions of dollars for abandoning a patently worthless property.

CNJ's second argument is that but for the Rail Act it would have been able to conclude an arrangement whereby the Port Authority would have acquired the Bridge for $4 million and become responsible for its removal. We find that CNJ has not established this scenario on the facts and consequently have no occasion to decide what the legal consequences would be if it had.

CNJ's factual showing rests almost wholly on testimony by R.D. Timpany who, as stated, became its Trustee in January, 1971. We summarize this as follows:

Timpany had become aware of the Port Authority's strong interest in finding a way to eliminate the Bridge, which was a hindrance to the development of Port Newark. The PC-LV Bridge was adequate to serve CNJ freight traffic to and from Jersey City and Bayonne along with that of its owners'. Removal of the Bridge "even with the expenses associated with its purchase from CNJ and the rerouting of CNJ traffic [over the PC-LV Bridge] was less expensive than alteration of the Bridge to eliminate the navigational obstruction and could be accomplished more quickly." Timpany (S) (Feb. 1984) at 3. Both the United States and the Port Authority would benefit on this account, PC and LV would obtain added revenue, the State of New Jersey could substitute less expensive bus service for the existing passenger service over the Bridge, and CNJ would save the expense of operating over the Bridge and could realize badly needed cash. Timpany began the complex negotiations needed to achieve these ends and so informed the Federal Railroad Administrator on March 6, 1971. The negotiations began well. "The concept . . . was that CNJ would sell the bridge to the Port Authority in return for a payment of $4,000,000 which was roughly the book value of the Bridge" and in addition the Coast Guard and the Port Authority were to reimburse it for the costs of

building necessary connections to the PC-LV Bridge and operating over it. Timpany (S) (Feb. 1984) at 5. Timpany had a clear recollection that a mutually satisfactory arrangement was reached in principle between CNJ, the Port Authority and the Coast Guard and that progress was also made with respect to New Jersey's substituting bus for rail passenger service. However, after a promising start, negotiations with PC for use of the PC-LV Bridge broke down.

Despite this a meeting attended by Timpany and representatives of the Port Authority and the Coast Guard was held on May 24, 1972. Timpany recalled that at the meeting he advised

> the Coast Guard and Port Authority that the book value of the CNJ Bridge was approximately $4,000,000, that CNJ expected to be compensated in such amount for the Bridge . . . . the Coast Guard indicated at the meeting that it wished to proceed as quickly as possible under the Truman-Hobbs Act to negotiate with the parties in interest to achieve removal of the CNJ Bridge.

Timpany (S) (Feb. 1984) at 7. As a result the Coast Guard wrote Timpany on June 22, 1972 that it was interested in entering into negotiation with him, PC and LV, and the Port Authority "to determine if an agreement could be reached under Section 13 of the Truman-Hobbs Act." Timpany (S) (Feb. 1984) Exh. 5. However, negotiations had been moving slowly and by July, 1972, had reached a complete impasse. Consequently, on July 18, 1972, Timpany applied to the ICC for an order directing PC and LV to Provide CNJ with operating rights over their bridge and related facilities. See Exhibit CNJ-Timpany (Dec. 1978)-22; GPs Reply In Support of Proposed Final Judgment Exh. 2 (Jan. 19, 1984). CNJ proposed to eliminate all its passenger traffic across the Bridge and to reroute its freight traffic across the PC-LV Bridge, which would have permitted "the subsequent dismantling of the CNJ bridge." *Id.* at 2. Although this proposal was opposed by PC and LV, see, *e.g.*, Timpany (S) (Feb. 1984) Exh.

7 (LV's Protest filed Aug. 23, 1972), the New Jersey Department of Transportation notified the ICC that New Jersey was "in full accord and support of [CNJ's Application] since it would eliminate a bridge which is old and in need of repairs but also an impediment to navigation in the Newark Bay area." GPs Reply In Support of Proposed Final Judgment Exh. 3 (Jan. 19, 1984) (Letter from Robert J. Bussolt, Deputy Attorney General, State of New Jersey, to Robert L. Oswald, Secretary, ICC (Sept. 19, 1972)). Timpany caused these proceedings to be halted on February 13, 1973, at the request of other carriers which were exploring proposals by New Jersey and others to achieve a merger or other consolidation of facilities among Reading, LV and CNJ.

Timpany asserted that "[u]ncertainty was introduced into these efforts when Senator Hartke's Committee began hearings in February, 1973 on the northeast rail crisis, the start of the legislative process which eventually resulted in the Rail Act." Timpany (S) (Feb. 1984) at 9. On August 17, 1973, the ICC advised Timpany that in view of the lack of progress toward an agreed solution it was considering a revival of the proceedings before it. However, essentially nothing more was achieved "in the brief period remaining before passage of the Rail Act ended all further efforts." *Id.* at 12.

This Port Authority scenario is reminiscent of the purchase by the State of New Jersey scenario which we rejected in the *Rail Use Opinion, supra*, 531 F. Supp. at 1378. We do not doubt that the Port Authority had serious discussions about playing some constructive role in the solution of the Bridge problem. We do doubt that the two Port Authority officials, now deceased, who are claimed by Timpany to have quickly acceded to his asking price of $4 million—Austin Tobin, its Executive Director, and Lyle King, its Director of Marine Terminals, in fact did so, as distinguished from listening politely to Timpany's presentation and not challenging it since doing so would have been premature until other pieces of the puzzle had been brought into place. Our experience, both before and after going on the bench, informs us

that businessmen are all too prone to make the mistake of identifying silence of public officials or other businessmen with agreement. Moreover, despite Tobin's great influence in the Port Authority, its By-Laws in effect in the early 1970's show that he had no power to commit the Authority to any such major project as this. There was simply no occasion for the Port Authority to discuss price with Timpany so long as there were no arrangements for CNJ's use of the PC-LV Bridge. What brought the 1972 discussions to an end, as Timpany in effect concedes, was the owners' refusal to negotiate for CNJ's use of the PC-LV Bridge. What might have happened but for the Rail Act as a result of the ICC's reactivating in 1973 the proceeding that Timpany had brought in July, 1972, is altogether too speculative to afford a basis for recovery by CNJ.

CNJ's third scenario is that but for the Rail Act the State of New Jersey would have acquired the Bridge along with CNJ's other properties.

CNJ's argument takes off from a statement in the *Rail Use Opinion, supra*, 531 F. Supp. at 1379:

> The GPs make no attempt to show that any particular CNJ line or facility would not have been acquired. . . . In the absence of any evidence that any particular line would not have been acquired, we hold that the GPs have not rebutted CNJ's showing that its entire system would have been purchased for rail use.

The GPs respond with a statement earlier on the same page:

> We accept CNJ's contention that, in the absence of the Rail Act, New Jersey would have bought all of CNJ's *conveyed* properties. (Emphasis supplied.)[20]

The GPs assert that by saying this the court implicity accepted testimony of Mr. Stangl, the former Deputy Commissioner of the New Jersey Department of Transportation, that New Jersey

"would not have had any interest in, and would not have bought the Newark Bay Bridge." Stangl (S) (Nov. 1979) at 32.

The two quotations are not in fact inconsistent. Our statement that the State would have bought all the conveyed properties—the only ones that we were obliged to value (apart from any question of severance damage)—is not inconsistent with a belief that in fact New Jersey would have purchased all the properties. Our statement to the latter effect, which was not essential to the *Rail Use* decision, was in general reasonable enough. The discussions between CNJ's Trustee and the State had proceeded on the basis of the latter's purchase of all of CNJ's properties. There had been no segregation studies, and, again speaking in general, it would have been no great hardship for the State to purchase all rather than some since the purchase would have been made at a price at which the properties could be liquidated if found to be unnecessary for rail service. Since no issue concerning the Bridge was before us, there was no need for us to give specific consideration to Stangl's testimony, and we did not.

Now that the issue is before us, we see no reason for not crediting his testimony. As our statement of the facts shows, the State was thoroughly acquainted with the problems of the Bridge; it knew full well that if it bought the Bridge it would be saddled with all removal costs unless arrangements with the Coast Guard under the Truman-Hobbs Act could be concluded while the Bridge was still in rail service. Although no final decision had been made, it had long been clear that needed passenger service could be furnished by bus. CNJ argues that the State would have needed the Bridge in order to compete with other carriers for freight to and from the Bayonne peninsula and Jersey City. However, the State's interest was that the traffic be served, not in the carrier who should serve it. See Peabody Study, Analysis of CNJ Freight Traffic by Line Segment, Sept 19, 1974, at 80, 1 CNJ Nonrail Use App. at 310 ("There is no traffic generated by [the Bridge] and it is not needed as a connection."). There is thus no sufficient reason to disbelieve Stangl's testimony that the

State, whose main interest in the Bridge was in its removal as a hazard to navigation in Newark Bay, would not have purchased it at the risk of incurring a heavy liability by doing so.

Although this factual finding that the State would not have purchased the Bridge disposes of CNJ's third scenario, there are other defects in CNJ's argument.

Even if the State had included the Bridge in the properties to be purchased from CNJ, it does not follow that it would have paid a price that did not reflect what CNJ would be obliged to pay for removal of the Bridge if it ceased rail operation over it. In our *CNJ Opinion, supra*, 571 F. Supp. at 1279, we characterized our *CMV* and *Rail Use Opinions* as having broadly concluded that non-rail use value for the condemned properties "was the value that could be obtained by sale for the next most valuable use, namely, a break-up of the railroad and a sale of its component parts." This principle envisions a process in which the State, as a knowledgeable buyer, would have computed what CNJ could have realized from scrapping the condemned properties, including such costs as the sealing of tunnels, the levelling of embankments and the removal of bridges, and paid only the proverbial dollar more, see, *e.g., New Haven Inclusion Cases*, 399 U.S. 392, 437 (1970); *CNJ Opinion, supra*, 571 F. Supp. at 1286. It was on this basis that we computed CNJ's non-rail use value in the *CNJ Opinion*. We see no reason to depart from this principle. If the State had purchased the Bridge along with the condemned properties, it would have insisted that full account be taken of the benefit it was thereby conferring by relieving CNJ of the burden of removing the Bridge at its own expense—a burden which CNJ would otherwise have been unable to unload. CNJ would have had no effective response to the State's demand for such a reduction in price. The only other way CNJ would have had to bring itself under the Truman-Hobbs Act, namely, by continuing the Bridge in rail service on its own account, was not open to it since it lacked the means to do this on a continuing basis unless heavily subsidized by the State.

CNJ argues against this that the State would nott have taken such a harsh position, particularly since it wouldl have been restrained by fear that if Timpany refused to selll at a price reduced by the anticipated cost of removing the Bridgge, as he says he would have, the State would have been obliged to resort to condemnation and the New Jersey courts might follow the decision of the New York Court of Appeals, purporting iin part to be applying New Jersey law, in *In re Port Authority Trans-Hudson Corp. (PATH)*, 20 N.Y.2d 457, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968), discussed in our *CMV Opinion, supra*, 445 F. Supp. at 1027-29, and again in our *Rail Use Opinion, supra*, 531 F. Supp. at 1325-26. CNJ says, in effect, that the State would not have administered such tough medicine as to say that the non-rail use value of its properties (which we have found to be $42,509,299 for the condemned properties) should be reduced in practical effect by as much as $14,000,000 less the value of any scrap obtained from the Bridge. However, this looks at only one aspect of the problem. If the State of New Jersey had purchased CNJ's properties with a view to continued operation over the Bridge, it would have been taking on an enormous burden in maintaining a heavily losing service for the indefinite future.[21] We thus would see nothing immoral in its insisting that the purchase price of the assets should be reduced to reflect a cost, even a very large one, that CNJ would have experienced on a scrap sale of its properties as a result of the Bridge Act, although the State would not incur it under the Truman-Hobbs Act if it continued a losing rail service over the Bridge. Putting the matter in a slightly different way, the Bridge was a $14 million albatross. CNJ could get rid of the bird only by (1) continuing operations over the Bridge, (2) moving them to the PC-LV Bridge and persuading the Coast Guard to treat this as a relocation so that the Truman-Hobbs Act would still apply, or (3) getting the State to continue them. The first possibility was excluded by CNJ's having become dependent on a state subsidy. The second had been blocked, at least for the time being, by the

intransigence of PC and LV. This left only the third. If the State was to continue the operations at heavy cost, it was entitled to ask that its service to CNJ be recognized by a reduction in the purchase price equivalent to what CNJ would have had to bear on a scrap sale. The albatross, after all, was CNJ's, not the State's. With respect to *PATH,* we add to our previous discussion only that the Hudson tunnels there at issue were a vital public service, "admittedly of great usefulness in the daily transportation of thousands of commuters", 20 N.Y.2d at 468, 285 N.Y.S.2d at 30, whereas the Bridge was of marginal usefulness—as witness the abandonment of already limited freight service in 1976 and of passenger service in 1978. There is thus serious doubt whether the rationale of *PATH* extends to the Bridge. Beyond that we adhere to the statement in our *Rail Use Opinion, supra,* 531 F. Supp. at 1326, which we quote for convenience in the margin.[22] Furthermore, if the State was seriously concerned that the New Jersey courts would follow *PATH* if it condemned the Bridge, New Jersey had the simple option of not condemning it. To be sure, this would have invited a claim for severance damage but, for reasons stated at the outset, we have the gravest doubt whether a failure to take which does not damage the untaken property except by lessening the chances of payment by the United States for its removal comes within that concept. Beyond this we have never found that if negotiations for the sale of CNJ's properties had collapsed, New Jersey would have condemned them; what the State would have done in that uncontemplated eventuality is completely uncertain.

In the *New Haven Inclusion Cases, supra,* 399 U.S. at 482, the Supreme Court said, although in a slightly different context, that a hopelessly losing railroad cannot be treated "as a liquidating enterprise with respect to certain items and as an operating railroad with respect to others, depending on which happens to yield the higher value." This seems to us a fairly appropriate characterization of CNJ's position with respect to the Bridge. It does not dispute that all its conveyed properties must be valued "as a

liquidating enterprise". It seeks, however, to have the unconveyed Bridge valued "as an operating railroad" facility—operating at least long enough so that the Coast Guard would have been obliged to pay a substantial portion of the cost of its alteration or removal. We can understand CNJ's assiduity in asserting this, since the amount at stake is indeed large in relation to the NLV of the conveyed properties. But the Bridge problem has been with CNJ for years and we see no sufficient basis, as a matter of fairness, let alone as a matter of constitutional requirement, for shifting to the United States the cost of removing a hindrance to navigation which was on the brink of becoming useless for rail service when the discussions leading to enactment of the Rail Act began.

We accordingly propose to sign the final judgment attached to the GPs' memorandum of April 19, 1984. We shall defer doing this until the disposition of any petition for reconsideration which CNJ may desire to file. Any such petition must be filed within twenty days from the filing of this opinion.

HENRY J. FRIENDLY

Henry J. Friendly, *Presiding Judge*

JOHN MINOR WISDOM

John Minor Wisdom, *Judge*

ROSZEL C. THOMSEN

Roszel C. Thomsen, *Judge*

Appendix N

FOOTNOTES

1. Although we agree that these provisions give us jurisdiction in the basic sense of power to pass upon CNJ's claims, we have remained troubled over the question of what remedy we could prescribe if we were to sustain them. Section 303(c)(2) states:

> If the special court finds that the terms of one or more exchanges for certificates of value and other benefits are not fair and equitable to an estate of a railroad in reorganization, or to a railroad leased, operated or controlled by a railroad in reorganization (taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad), which has transferred rail properties pursuant to the final system plan, it may—
>
> (A) enter a judgment reallocating the certificates of value in a fair and equitable manner if they have not been fairly allocated among the railroads transferring rail properties to the Corporation or any subsidiary thereof, except that one certificate of value shall be allocated to each such railroad; and
>
> (B) if the lack of fairness and equity cannot be completely cured by a reallocation of the certificates of value, order the Corporation to provide for the transfer to the railroad of certificates of value issued by the Association as designated in the final system plan in such nature and amounts as would make the exchanges fair and equitable; and
>
> (C) enter a judgment against the Corporation if the judgment would not endanger the viability or solvency of the Corporation.

Subparagraph (A), even if intelligible, would no longer be available since CNJ is the only transferor remaining. We have never been able to understand subparagraph (B), see *180 Day Appeals*, 384 F. Supp. 895, 929 & n.64 (1974). This leaves subparagraph (C). Although it now seems likely that any judgment of the magnitude sought by CNJ "would not endanger the viability or solvency" of Conrail, we have characterized this as "a rather curious" remedy, *180 Day Appeals, supra*, 384 F. Supp. at 929, and Conrail strongly objects to our invoking it. Another possibility would be for us to declare that CNJ was constitutionally

entitled to a certain amount in addition to NLV, and to leave that declaration to be enforced by a suit under the Tucker Act in the Claims Court, 28 U.S.C. § 1491; this too has its difficulties. In the light of our disposition on the merits, it becomes unnecessary to deal with the question of remedy.

2. We went on to say that we proposed to instruct the special masters who were then contemplated

> that in valuing the properties they need not address themselves to the fair and equitable standard as distinguished from the constitutional minimum in the absence of a specific and supported claim that a different result would ensue from application of such a standard, in which event the master shall seek this Court's further instructions.

425 F. Supp. at 270.

3. In fact, the 86 figure is a yield to maturity, reflecting the upward pull of the certainty of the payment of the bond at face value on the maturity date.

4. It is not altogether clear whether the statement in *Blankinship* "that the 6 percent figure employed by Congress in the Declaration of Taking Act cannot be viewed as a ceiling on the rate of interest allowable in computing just compensation with respect to a deficiency", 543 F.2d at 1276, rested on an interpretation of 40 U.S.C. § 258a (including the canon of interpreting so as to avoid constitutional doubts, see, *e.g.*, *United States* v. *Rumely*, 345 U.S. 41, 45 (1953) (Frankfurter, J.)), or on a holding that the specification of a 6% interest rate had become unconstitutional. The Court of Claims seems to have taken the former view, *Miller* v. *United States*, 620 F.2d 812, 837 (Ct. Cl. 1980), discussed *infra;* see also *United States* v. *329.73 Acres*, 704 F.2d 800, 812 (5 Cir. 1983) (en banc); we would be inclined to take the latter. So, as we read its opinion, does the Supreme Court, see *Kirby Forest Indus.* v. *United States*, 52 U.S.L.W. 4607, 4610 n.16 (May 21, 1984). The same footnote tells us that the Government in its brief to the Court indicated that it has acquiesced in the decisions that the 6% rate provided in the Declaration of Taking Act is not a ceiling.

5. CNJ's proposed rates are:

Apr. 1, 1976—Mar. 31, 1977	8.33%
Apr. 1, 1977—Mar. 31, 1978	8.20%
Apr. 1, 1978—Mar. 31, 1979	8.96%
Apr. 1, 1979—Mar. 31, 1980	10.21%
Apr. 1, 1980—Mar. 31, 1981	12.50%
Apr. 1, 1981—Mar. 31, 1982	14.08%
Apr. 1, 1982—Mar. 31, 1983	13.08%
Apr. 1, 1983—Dec. 31, 1983	8.64%

For subsequent years, CNJ invites the court to refer to Moody's Composite Index on Yields on Long Term Corporate Bonds rate Aaa, which is the source of its proposed rates. See CNJ Answer and Memorandum at 23 (Jan. 5, 1984).

6. This seems to be the point made by Judge Skelton in his dissent in *Tektronix, Inc.* v. *United States*, 552 F.2d 343, 356 (Ct. Cl. 1977) (en banc), *cert. denied*, 439 U.S. 1048 (1978).

While CNJ brings to our attention that "following emergence from the CNJ reorganization proceedings in 1979 it placed its cash assets in short term instruments, principally bank CDs, with resulting average yearly yields ranging from 13.3% to 16.3% during the years 1979 to 1982", it recognizes that "[t]he courts, however, have not looked with favor upon determining the appropriate rate of interest on the basis of the individual claimant's circumstances or experience." CNJ Answer and Memorandum at 20-21 (Jan. 5, 1984). Beyond this, bank CDs are not risk-free.

7. Any computation on the basis of yields available on short-term Government obligations would have to take into account the transaction costs on frequent roll-overs. These could not be avoided by purchasing shares in a money market fund holding only short-term government securities; the fund itself would have the transaction costs and would charge a management fee as well.

8. Although the legislative history does not inform us why December 31, 1987 was chosen as the maturity of the CVs, it is fair to assume that Congress thought it would take that long to fix just compensation. The thought was not unreasonable. If it had proved necessary to make a final determination as to all of the 23 railroads, including the giant Penn Central and its lessors, rather that as to only one, we would have been hard-pressed to complete the job by the end of 1987 even with the

expedited procedures we have developed. In the settlements we have approved, USRA has not exercised its right to defer payment until December 31, 1987; we have no reason to doubt its willingness to follow the same course here once the amount payable to CNJ is determined.

9. To the extent that there was any such anticipation, it would, of course, have been reflected in the yields prevailing on April 1, 1976. In fact, as shown by CNJ's figures on long-term corporate bond yields, see *supra* note 5, yields in the period April 1, 1977 - March 31, 1978, declined from those in the previous year.

10. The condemnee's proof in *Eveandra* was quite similar to that of CNJ's in the instant case. The condemnee asserted that the "prevailing and proper" interest rate for the period 1972-77 was 9.75%. This position was supported by expert testimony: (1) a New York bank vice-president testified as to the prevailing prime rates of interest and the practices of banks in the New York metropolitan area; (2) a Columbia University finance professor, after studying prevailing interest rates on borrowing and rates of return on investments during the period, testified that "the applicable rate is midpoint between average borrowing cost during [1972-1977] of 12 per cent per annum, and [New York] county's return on short term investments of 7.5 per cent per annum, which midpoint is 9.75 per cent per annum." Juris. Statement for Appellant, *County of Nassau* v. *Eveandra Enterprises, Inc.*, No. 77-210, at 6. Thus, the condemnee asserted that "[t]his proof established the just compensation that [he] was entitled to by the Fifth Amendment made applicable to the Fourteenth Amendment," *id.* at 2, and stated that the Court's jurisdiction was based on 28 U.S.C. § 1257(2).

The New York Court of Appeals in *In re City of New York*, 58 N.Y.2d 532, 462 N.Y.S.2d 619 (1983) (per curiam), has recently characterized *Eveandra* as standing only for the proposition that the statutory 6% rate for the years 1972-1977 was not so "unreasonably low" as to deprive condemnees of just compensation given the fact that interest rates fluctuated around 6% during the period, *id.* at 538, 462 N.Y.S.2d at 627, and approved the action of a trial court which, after reviewing economic reports showing that interest rates on medium term public securities "consistently rose far above 6% during the period 1978-1981," applied a median interest rate of 9% for that period in order to avoid using the statutory rate that had become so "unreasonably low", *id.* at 536, 402 N.Y.S.2d at 620, saying that "the statutory rate is entitled to a presumption of reasonableness, not a presumption of constitutionality", *id.* at

538 n.2, 462 N.Y.S.2d at 662 n.2. This may decrease but does not altogether remove the force of the Supreme Court's action in *Eveandra*.

11. What we have said here is not in direct conflict with *Blankinship, supra*, 543 F.2d at 1276, or *Miller, supra*, 620 F.2d at 837. *Blankinship* dealt with a 6% rate of interest provided in the Declaration of Taking Act, enacted in 1931, 46 Stat. 1421; this scarcely represented a considered judgment by Congress as to what would constitute a fair rate for a taking in 1973. The *Miller* court, applying the principle of construing so as to avoid serious constitutional doubt, see, *e.g., United States* v. *Thirty-Seven Photographs*, 402 U.S. 363, 369 (1971), construed Pub. L. No. 90-545 as setting 6% interest as a floor rather than a ceiling, thereby leaving the courts free to require higher rates without having to declare the statute unconstitutional. We find it impossible to construe § 306(c)(4)(D) of the Rail Act to mean anything other than what it carefully and clearly says.

12. We there said, 439 F. Supp. at 1380:

> CNJ was atypical in several respects. It carried a burden of commuter passenger traffic in the northern New Jersey metropolitan area which was huge in comparison with its total operations; its freight services were almost entirely those of a terminating or originating carrier; and we are told that its divisions with longer-haul carriers moving the traffic from and to the west were unfavorable—particularly the divisions in the Wilkes-Barre—Scranton, Pa., area.

See, to the same effect, *Rail Use Opinion* 531 F. Supp. 1191, 1380 (1981):

> [CNJ] had not reported an annual profit since 1957; by 1973, it showed a negative net worth. It was in arrears on interline balances and on scheduled wage increases for its employees. It had already begun disposing of some of its facilities and operations; in 1971-72, it halted its New Jersey harbor lightering operations, its Jersey City coal dumping activities, its entire Pennsylvania freight operation, and its service on several small branch lines.

13. Although we have done our best to reconstruct the result that such bargaining would have produced, we have the gravest doubt that if Congress had not intervened with the Rail Act, CNJ, in the resulting

chaos, could have realized $42,509,299 for the conveyed properties. For one thing, our estimate was predicated on the hypothesis that, although discontinuance of CNJ service was assumed, service by other carriers would continue, thus enhancing the value of CNJ's land and facilitating disposition of other assets. This would have been impossible but for the Rail Act.

14. We see no force in CNJ's argument that use of an 8% compound interest rate with respect to the CVs is unconstitutional because CNJ stipulated that the estimated proceeds of sale should be discounted back to April 1, 1976, at the rate of 15.22%, see 571 F. Supp. at 1294 n.34. The 8% rate was reasonable when viewed *ex ante*. While we do not know how the 15.22% stipulated rate was arrived at, presumably it viewed the situation *ex post*. We likewise have given no weight to the GPs' argument that the 8% rate is validated by the fact that, under CNJ's reorganization plan, notes paid from proceeds of this case bear interest at 8%.

15. The Bridge replaced an older wooden structure constructed pursuant to an act of the New Jersey legislature, see 1860 N.J. Laws ch. 64.

16. The FSP has this to say with respect to the Bridge, Vol. II, p. 215:

> Information for Line-Transfer Decision
>
> Bayonne shippers will continue to be served by ConRail via the existing Lehigh Valley bridge which is located 3 miles to the north of the CNJ bridge. Subsequent dismantling of the CNJ bridge will remove a serious navigational hazard for ocean shipping moving between Newark Bay and New York Harbor. Elimination of the bridge will, however, sever a lightly patronized suburban passenger service. (The State of New Jersey has expressed some interest in rerouting this service.)
>
> Disposition
>
> The Newark Bay Bridge is *not* designated for transfer to Consolidated Rail Corp.
>
> *Continuation of passenger services using this bridge is dependent on the purchase, lease or other transfer of the necessary facilities to a public body.* (Emphasis in original.)

Appendix N

The deeds executed by the CNJ Trustee conveying to Conrail CNJ's rail property in Hudson and Union counties provided respectively:

> The part of the line of railroad [excepted] begins at the lateral cut line in Bayonne and extends to the [Hudson] County line at the Newark Bay Bridge.
>
> The part of the line of railroad [excepted] begins at the lateral cut line in Elizabethport and extends to the [Union] County line in Newark Bay.

CNJ-CRC-RP-7, at B-11; CNJ-CRC-RP-15, at B-2. CNJ's retention of the Bridge was subject to the following easement for commuter service, granted to Conrail, which was part of both deeds:

> Subject to the easement and right to use . . . the existing bridge or bridges, track or tracks, and track or tracks on such bridges, located on and across the [Newark Bay Bridge] for so long as passenger train service is operated to the City of Bayonne.

CNJ-CRC-RP-7, at B-11; CNJ-CRC-RP-15, at B-2.

17. In *Union Bridge Co.*, the Court held that the duty of a bridge owner to make alterations to eliminate an unreasonable obstruction to navigation and to bear all the cost, pursuant to the Secretary of War's order under § 18 of the Rivers and Harbors Act of 1899, ch. 425, 30 Stat. 1121, 1153, was not a taking within the Fifth Amendment.

18. This was conceded in various studies referred to in our *CNJ Opinion*, *e.g.*, the Wyer Dick Study, Exhibit CNJ-Timpany (Dec. 1978)-19, at 39-40; the DeLeuw Cather Study, Exhibit CNJ-Jacoby (Dec. 1978)-57, at 30; the Peabody Study, Exhibit CNJ-Jacoby (Dec. 1978)-62, at 48-49.

19. CNJ relies particularly on *State* v. *William C. Rohrer, Inc.*, 145 N.J. Super. 63, 366 A.2d 1017 (1976), *aff'd per curiam*, 161 N.J. Super. 561, 392 A.2d 162 (App. Div. 1978), *vacated and remanded*, 80 N.J. 462, 404 A.2d 29 (1979). This is a classical case of severance damage. The State took part of a building in order to widen a highway; the cost of reconstructing the remainder of the building exceeded its value. Such novelty as there is in the case is the holding of the Supreme Court of New Jersey with respect to the remedy, namely, allowing the condemnee the option of treating the condemnation as of the whole building. *Id.* at 468, 404 A.2d at 32. While pursuing this analogy

would enable CNJ to thrust on Conrail ownership of the Bridge and consequent liability for removal costs, we find nothing in the just compensation clause authorizing us to require the Government to take property it does not want, as distinguished from requiring it to pay damages for injury which its taking has inflicted on property not taken. The Rail Act clearly puts decision as to what property is to be taken in USRA, not in this court.

20. We quoted the phrase in the *CNJ Opinion,* 571 F. Supp. 1269, 1279 (1983).

21. We say this since the State could not have become party to an arrangement whereby the United States paid the bulk of the alteration costs under the Truman-Hobbs Act unless it had a *bona fide* intention of continuing operations. The State would have had no more assurance than CNJ that it would have been possible to work out a multi-party agreement whereby operations would have been routed over the PC-LV Bridge, with the United States paying most of the costs of relocation and removal.

22. While technically the New York Court of Appeals in *PATH* applied New Jersey law to the condemned property in New Jersey, all the court had to say on that score was that New Jersey law was similar to the general rule followed in New York and in the federal jurisdiction and that the case before it was *sui generis,* rendering it impossible to make with certainty any statements predicting the reaction of the New Jersey Supreme Court. No New Jersey cases following *PATH* have been cited to us and we are not aware of any. Thus, there is no good reason to take the going concern value portion of the *PATH* opinion as indicative of what New Jersey courts would decide New Jersey's own law to be in the condemnation of the Ts' passenger lines. And there can be little doubt that public officials would not have paid such premiums by way of settlement for fear that a New Jersey court would follow the going concern value holding of *PATH*. . . . We thus need not rule on the GPs' argument that for this court to recognize a premium based on a state court's decisional law that is in conflict with federal condemnation law would violate principles of federal supremacy.

APPENDIX O

CA-863

Appendix O

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 23, 1984, James F. Davey, Clerk

Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

FINAL JUDGMENT UPON CLAIMS OF CENTRAL RAILROAD COMPANY OF NEW JERSEY UNDER SECTIONS 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

On April 1, 1976, rail properties were conveyed to Consolidated Rail Corporation and other transferees by, *inter alia*, the Trustee of the Central Railroad Company of New Jersey and six affiliated transferors, Communipaw Central Land Co., Dover & Rockaway Railroad Co., Mt. Hope Mineral Railroad Co., Wharton & Northern Railroad Co., Bay Shore Connecting Railroad, and Central Railroad Co. of Pennsylvania (hereinafter "CNJ and its affiliates"), pursuant to Section 303(b) fo the Regional Rail Reorganization Act of 1973, as amended ("Rail Act").

Section 303(c) of the Rail Act requires this Court to determine whether the conveyances of rail properties by CNJ and its affiliates, in exchange for certificates of value issued by United States Railway Association ("USRA") pursuant to Section 306(b) of the Rail Act, are in the public interest and fair and equitable to each transferor or are more fair and equitable than is required as a constitutional minimum; and whether any of the proceeds received for the conveyance of such rail properties reflects value attributable to the maintenance or improvement of property pursuant to an agreement under Sections 213, 215(a)(1) or

215(a)(2) of the Rail Act. Section 306(c)(4) fo the Rail Act requires this Court to determine the base value of each certificate of value issued to a transferor by (A) taking the net liquidation value of the properties conveyed by that transferor; (B) subtracting the value of other benefits provided under the Rail Act; (C) adding any amounts required for compensable unconstitutional erosion; (D) adding interest from April 1, 1976 to the date of redemption of the certificates of value at a rate of 8% per annum compounded annually; and (E) dividing the resulting value by the number of certificates of value issued to that transferor.

This Court has previously held that net liquidation value, within the meaning of Section 306(c)(4)(A) of the Rail Act, satisfies the requirements of constitutional minimum value, within the meaning of the Fifth Amendment to the U.S. Constitution and Section 303(c) of the Rail Act.

On December 5, 1983, this Court entered its Order Making Certain Findings and Determination Pursuant to Section 306(c)(4) of the Regional Rail Reorganization Act of 1973, in which it found that:

> 1. The total net liquidation value, within the meaning of Section 306(c)(4)(A) of the Rail Act, of the rail properties conveyed by CNJ and its affiliates pursuant to Section 303(b) of the Rail Act, is $42,509,299 as of April 1, 1976.
>
> 2. The value of other benefits ("VOB") within the meaning of Section 306(c)(4)(B) of the Rail Act, provided to CNJ and its affiliates, and each of them, is zero.
>
> 3. The compensable unconstitutional erosion ("CUE"), within the meaning of Section 303(c)(1)(A)(i) and Section 306(c)(4)(C) of the Rail Act, suffered by CNJ and its affiliates, and each of them, is zero.

Appendix O

On December 19, 1983, Central Jersey Industries, Inc. ("CJI"), the corporate successor to CNJ following reorganization, submitted to the Court and all interested persons a proposed allocation among CNJ and its affiliates of the total net liquidation value set forth above. All objections to that proposed allocation have been duly considered by the Court.

In our CMV Opinion, 445 F. Supp. 994, 1041 (1977), this Court indicated that the "principle of severance damage" appeared to be applicable in these proceedings. CJI has raised claims of severance damage with respect to its former railroad bridge over lower Newark Bay. In addition, CJI has claimed that the compounded annual 8% interest rate with respect to the certificates of value, as provided in Section 306(c)(4) of the Rail Act, is constitutionally inadequate. In accordance with our December 5, 1983 Memorandum Accompanying Judgment under Section 306(c)(4) of the Rail Act and our January 25, 1984 Order With Respect to Further Proceedings Under Section 303(c) of the Rail Act, the parties have submitted additional evidence and memoranda upon these two claims of CJI, and the Court heard oral argument on May 16, 1984.

The parties have separately indicated their concurrence that any judgment in favor of CJI and the CNJ affiliates for the sale, lease or transfer of rail properties, based upon net liquidation value of those properties, plus interest, will not include any amount reflecting value attributable to the maintenance or improvement of property pursuant to an agreement under Sections 213, 215(a)(1) or 215(a)(2) of the Rail Act.

Having considered the proposed form of judgment submitted by the Government Parties, the objections of CJI thereto and the Government Parties' reply, the further evidentiary materials filed by the parties, their written and oral arguments, and all prior submissions and proceedings in this case;

The Court hereby finds and determines as follows:

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1. The net liquidation value, within the meaning of Section 306(c)(4)(A) of the Rail Act, as of April 1, 1976, of the rail properties conveyed by CNJ and its affiliates pursuant to Section 303(b) of the Rail Act is as set forth in Table 1 hereto.

2. The value of other benefits, within the meaning of Section 306(c)(4)(B) of the Rail Act, provided to CNJ and its affiliates is zero as set forth in Table 1 hereto.

3. The compensable unconstitutional erosion, within the meaning of Section 303(c)(1)(A)(i) and Section 306(c)(4)(C) of the Rail Act, suffered by CNJ and its affiliates is zero as set forth in Table 1 hereto.

4. The base value of the Certificates of Value within the meaning of Section 306(c)(4) to be delivered to CJI on behalf of CNJ and its affiiiates shall be as set forth in Table 1 hereto, as of December 31, 1987. In the event any Certificate of Value is redeemed prior to such date, the base value shall be recalculated to reflect interest at the rate provided in Section 306(c)(4) from April 1, 1976 to and including the date of redemption, and not thereafter.

5. The transfers and conveyances of rail properties by CNJ and its affiliates in exchange for the Certificates of Value set forth in Table 1 hereto having the principal amount set forth in Table 1 and the other benefits accruing to CNJ and its affiliates as a result of such exchange are in the public interest and are fair and equitable to CNJ and its affiliates in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under Section 77 of Bankruptcy Act (11 U.S.C. § 205), as it was in effect at the time of the commencement of these proceedings, and with the standard of fairness and equity applicable to a railroad that is not itself in reorganization but which is leased, operated, or controlled by a railroad in reorganization,

and are not more fair and equitable than is required as a constitutional minimum

6. No portion of any proceeds received by CNJ and its affiliates for the sale, lease or transfer of property reflects value attributable to the maintenance or improvement of property pursuant to an agreement under Sections 213, 215(a)(1), or 215(a)(2) of the Rail Act.

7. The Court has jurisdiction under the Rail Act to decide whether CNJ suffered severance damages as a result of the decision to permit CNJ's Newark Bay Bridge to be retained by the estate, and the Court finds that CNJ has not suffered any compensable severance damages resulting from the decision to permit the estate to retain such property.

8. The Court has jurisdiction under the Rail Act to decide the constitutional adequacy of the statutory rate of interest provided under Section 306(c)(4) of the Rail Act, and the Court finds that the interest rate provided therein is constitutionally sufficient.

In view of the findings and determinations made herein, it is hereby, ORDERED AND ADJUDGED that within ten (10) days following the effective date of this Order:

1. United States Railway Association shall deliver to the Clerk of the Court, and the Clerk shall deliver to CJI on behalf of CNJ and its affiliates, instruments evidencing the number of Certificates of Value set forth opposite the name of CNJ and each of its affiliates set forth in Table 1 hereto, each such series of Certificates of Value to have the aggregate principal amount set forth in Table 1 hereto for said series.

2. The Clerk shall endorse upon the consolidated instrument evidencing Certificates of Value deposited with

the Clerk pursuant to Section 306(a) of the Rail Act a notation that Certificates of Value in the numbers and amounts listed in Table 1 hereto have been distributed pursuant to this Order and that the number of Certificates of Value evidenced by that consolidated instrument is accordingly reduced.

This Order and the findings and determinations made in it shall be effective from and after the date of its entry.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

DATED: July 23, 1984

FILED
JUL 23 1984
JAMES F. DAVEY, Clerk

TABLE 1

Transferor	*NLV*	*VOB*	*CUE*	*Principal Amount of CV's*	*Statutory Interest on CV's at 12-31-87*	*Aggregate Base Value of CV's at 12-31-87*	*Number of Certificates in Series*	*Base Value of each CV at 12-31-87*
The Central Railroad of New Jersey	$40,874,734	0	0	$40,874,734	$60,159,106	$101,033,840	443,654	$ 227.73
Communipaw Central Land Company	227,785	0	0	227,785	335,252	563,037	106	5,311.67
Dover and Rockaway Railroad Company	76,933	0	0	76,933	113,229	190,162	1,012	187.91
Mt. Hope Mineral Railroad Company	106,555	0	0	106,555	156,827	263,382	570	462.07
Wharton & Northern Railroad Company	119,597	0	0	119,597	176,022	295,619	1,280	230.95
Bay Shore Connecting Railroad	240,661	0	0	240,661	354,203	594,864	512	1,161.84
Central Railroad Co. of Pennsylvania	863,034	0	0	863,034	1,270,207	2,133,241	15,475	137.85

APPENDIX P

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Central Jersey Industries, Inc. hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Central Jersey Industries, Inc.

By: STANLEY WEISS
.....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

CERTIFICATE OF SERVICE

I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

Solicitor General
10th & Constitution Avenue, N.W.
Washington, D.C. 20530

United States Railway Association
95 L'Enfant Plaza North, S.W.
Washington, D.C. 20595

United States Department of Justice
10th & Constitution Avenue, N.W.
Washington, D.C. 20530

United States Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590

Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Bay Shore Connecting Railroad hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Bay Shore Connecting Railroad

By: STANLEY WEISS
.....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

CERTIFICATE OF SERVICE

I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

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Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

SPECIAL COURT—MISC. NO. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that The Central Railroad of Pennsylvania hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
The Central Railroad of Pennsylvania

By: STANLEY WEISS .....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

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United States Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Communipaw Central Land Company hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Communipaw Central Land Company

By: STANLEY WEISS
.....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

CERTIFICATE OF SERVICE

I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

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400 7th Street, S.W.
Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Dover and Rockaway Railroad Company hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Dover and Rockaway Railroad Company

By: STANLEY WEISS
.....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

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I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

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Washington, D.C. 20530
United States Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Mt. Hope Mineral Railroad Company hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Mt. Hope Mineral Railroad Company

By: STANLEY WEISS .....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

CERTIFICATE OF SERVICE

I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

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Washington, D.C. 20530
United States Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
123 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix P

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed July 30, 1984, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Wharton and Northern Railroad Company hereby appeals to the Supreme Court of the United States from the final judgment of the Special Court Regional Rail Reorganization Act of 1973, entered on July 23, 1984.

This appeal is taken pursuant to 45 U.S.C. 743(d) and 28 U.S.C. § 1253.

CARPENTER, BENNETT & MORRISSEY
Attorneys for Appellant
Wharton and Northern Railroad Company

By: STANLEY WEISS .....
STANLEY WEISS
DEAN R. MAY

Dated: July 25, 1984

Appendix P

CERTIFICATE OF SERVICE

I, Stanley Weiss, a member in good standing of the Bar of the Supreme Court of the United States, hereby certify that on this day I caused a copy of this Notice of Appeal to the Supreme Court of the United States to be (i) served upon the following pursuant to Rule 28.3 of the Rules of the Supreme Court of the United States, by mailing said document, properly addressed, by first class mail to:

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10th & Constitution Avenue, N.W.
Washington, D.C. 20530
United States Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590
Consolidated Rail Corporation
c/o Laurence Z. Shiekman, Esq.
Pepper, Hamilton & Schetz
129 South Broad Street
Philadelphia, Pennsylvania 19109;

and (ii) served in accordance with Rules 9 and 11 of the Special Court.

All parties required to be served have been served.

STANLEY WEISS

.....
Stanley Weiss

Dated: July 25, 1984

Appendix Q

Appendix Q

PERTINENT PROVISIONS OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973, AS AMENDED

Section 303, 45 U.S.C. § 743, provides:

(a) Deposit with court.—Within 10 days after delivery of a certified copy of a final system plan pursuant to section 719(c) of this title—

(1) the Corporation, in exchange for the rail properties of the railroads in reorganization in the region and of railroads leased, operated, or controlled by railroads in reorganization in the region to be transferred to the Corporation or any subsidiary thereof, shall deposit with the special court all of the stock and other securities of the Corporation and certificates of value issued by the Association designated in the final system plan to be exchanged for such rail properties;

(2) each profitable railroad operating in the region and each State or responsible person (including a government entity) purchasing rail properties from a railroad in reorganization in the region, or from a railroad leased, operated, or controlled by a railroad in reorganization in the region, as provided in the final system plan shall deposit with the special court the compensation to be paid for such rail properties.

(b) Conveyance of rail properties.—(1) The special court shall, within 10 days after deposit under subsection (a) of this section of the securities of the Corporation, certificates of value issued by the Association, and compensation from the profitable railroads operating in the region, States and responsible persons, order the trustee or trustees of each railroad in reorganization in the region to convey forthwith to the Corporation or any subsidiary thereof the respective profitable railroads operating in the region, States, and responsible persons all right, title, and interest in the rail properties of such railroad in reorganization and shall

itself order the conveyance of all right, title, and interest in the rail properties of any person leased, operated, or controlled by such railroad in reorganization that are to be conveyed to them under the final system plan as certified to such court under section 719(d) of this title. In any case where the special court orders the trustee or trustees of a railroad in reorganization in the region to execute and deliver deeds or other instruments conveying rail properties to the Corporation or a subsidiary thereof or to a profitable railroad operating in the region or a State or responsible person, those deeds or other instruments may be executed, acknowledged, and delivered on behalf of the trustee or trustees by any person or persons who have been duly authorized to perform such acts on behalf of the trustee or trustees by the district court of the United States or any other court having jurisdiction over the respective railroad in reorganization in the region. Notwithstanding any provision of State or local law, in any case where deeds or other instruments have been executed, acknowledged, or delivered by a representative of the trustee or trustees of a railroad in reorganization in the region in accordance with the previous sentence, such execution, acknowledgment, and delivery, and the deeds or other instruments to which they pertain, shall have the same legal effect as they would have had if the trustee or trustees had themselves executed, acknowledged and delivered such deeds or other instruments.

(2) All rail properties conveyed to the Corporation or any subsidiary thereof, the respective profitable railroads operating in the region, States, and responsible persons under this section shall be conveyed free and clear of any liens or encumbrances, but subject to such leases and agreements as shall have previously burdened such properties or bound the owner or operator thereof in pursuance of an arrangement with any State, or local or regional transportation authority under which financial support from such State, or local or regional transportation authority was being provided on January 2, 1974, for the continuance of rail

passenger service or any lien or encumbrance of no greater than 5 years' duration which is necessary for the contractual performance by any person of duties related to public health or sanitation. Such conveyance shall not be restrained or enjoined by any court.

(3)(A)(i) Notwithstanding any other provision of this chapter if an interest in railroad rolling stock is included in rail properties conveyed pursuant to subsection (b)(1) of this section, and if such conveyance is in accordance with the requirements of clause (ii) of this subparagraph, the conveyance of such properties shall be deemed an assignment. Any such assignment shall relieve the assignor of liability for any breach which occurs after the date of such conveyance, except that such assignor shall remain liable for any breach, event of default, or violation of covenant which occurred (and any charges or obligations which accrued) prior to the date of such conveyance, regardless of whether the assignee thereof assumes such liabilities, charges or obligations. If any such liabilities, charges, or obligations (accrued prior to the date of such conveyance) are paid by or on behalf of any person or entity other than such assignor, such person or entity shall have a claim to direct reimbursement, as a current expense of administration, from such assignor, together with interest on the amount so paid.

(ii) A conveyance referred to in clause (i) of this subparagraph may be effected only if—

(I) the Corporation or a subsidiary thereof, the profitable railroad operating in the region, or the State or responsible person to whom such conveyance is made assumes all of the obligations under any applicable conditional sale agreement, equipment trust agreement, or lease with respect to such rolling stock (including any obligations which accrued prior to the date on which such properties are conveyed), and

(II) such conveyance is made subject to such obligations.

As used in this subparagraph, the term "railroad rolling stock" means assets which could be carried in Interstate Commerce Commission account numbers 52, 53, 54, and 57.

(B) Subject to the provisions of this paragraph, the provisions of this chapter shall not affect the title and interests of any lessor, equipment trust trustee, or conditional sale vendor under any conditional sale agreement, equipment trust agreement, or lease under section 205(j) of Title 11. A profitable railroad operating in the region, the Corporation or a subsidiary thereof, or a State or responsible person, to whom such a conveyance is made as assignee or as lessee, shall assume all liability under such conditional sale agreement, equipment trust agreement, or lease. Such an assignment or conveyance to, and such an assumption of liability by, such a profitable railroad, Corporation, subsidiary, State, or responsible person shall not be deemed a breach, an event of default, or a violation of any covenant of any such conditional sale agreement, equipment trust agreement, or lease so assigned or conveyed, notwithstanding any provisions of any such agreement or lease.

(4) Notwithstanding anything to the contrary contained in this chapter, if a railroad in reorganization has leased rail properties from a lessor that is neither a railroad nor controlled by or affiliated with a railroad, and such lease has been approved by the lessee railroad's reorganization court prior to January 2, 1974, conveyance of such lease may only be effected if the Corporation, profitable railroad, State, or responsible person to whom the conveyance is made assumes all future liability under such lease and all of the terms and conditions specified in the lease, including the obligation to pay the specified rent to the non-railroad lessor.

(5) Notwithstanding any covenant, undertaking, condition, or provision of any sort in any lease, agreement, or contract, the conveyance, transfer, assignment, or other disposition of such lease, agreement, or contract or of any interest therein to, or the assumption by, the Corporation or any subsidiary thereof, or a

profitable railroad of obligations thereunder, shall not be deemed a breach, an event of default, or a violation of any covenant of such lease, agreement, or contract.

(6) Notwithstanding anything to the contrary contained in this chapter or any other[1] provision of law, the special court shall include in its order such further directions as may be necessary to assure (A) that the operation and administration of the employee pension benefit plans described in section 775(a) of this title shall be continued, without termination or interruption, by the Corporation until such time as the Corporation elects to amend or terminate any such plan, in whole or in part; and (B) that appropriate transfers and assignments with respect to all rights and obligations relating to such plans shall be made to the Corporation for such purposes, without prejudice to payment of consideration for whatever rights any railroad in reorganization may have in any residual assets under any such employee pension benefit plan. No court shall enter any judgment against the Corporation with respect to any such rights, except that the special court may enter such a judgment in an order issued by it pursuant to subsection (c) of this section, after taking into consideration the rights and obligations transferred pursuant to this paragraph. All liabilities as an employer shall be imposed solely upon the railroad in reorganization in the event such plan is terminated, in whole or in part, by the Corporation within 1 year after the date of such transfer or assignment (except liabilities as an employer under the Employee Retirement Income Security Act of 1974 for benefits accruing during such period), except that in any case in which the Corporation, on or after the date of transfer or assignment as provided by this paragraph, terminates in whole or in part any such plan, the benefits under which are not guaranteed under title IV of the Employee Retirement Income Security Act of 1974, the Corporation shall guarantee the payment when due of the accrued pension benefits provided for thereunder at the time of

termination. The Corporation shall be entitled to a loan pursuant to section 721(h) of this title in an amount required for the adequate funding of accrued pension benefits under all plans transferred or assigned to the Corporation in accordance with this paragraph (whether or not terminated by the Corporation). For purposes of such section 721(h) of this title and notwithstanding any other provision of Federal or State law, amounts required for such adequate funding shall be deemed to be expenses of administration of the respective estates of the railroads in reorganization, due and payable as of the date of transfer or assignment of the plans to the Corporation.

(c) Findings and distribution.—(1) After the rail properties have been conveyed to the Corporation or any subsidiary thereof profitable railroads operating in the region, States and responsible persons under subsection (b) of this section, the special court, giving due consideration to the findings contained in the final system plan, shall decide—

(A) whether the transfers or conveyances—

(i) of rail properties of each railroad in reorganization, or of each railroad leased, operated or controlled by a railroad in reorganization, to the Corporation or any subsidiary thereof in exchange for the securities, certificates of value and the other benefits accruing to such railroad as a result of such exchange (taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad) as provided in the final system plan and chapter, and

(ii) of rail properties of each railroad in reorganization, or of each railroad leased, operated, or controlled by a railroad in reorganization, to a profitable

railroad operating in the region, in exchange for compensation and other benefits accruing to such transferor as a result of such exchange (taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad) State, or responsible person in accordance with the final system plan,

are in the public interest and ar fair and equitable to the estate of each railroad in reorganization in accordance with the standard of fairness and equity applicable to the approval of a plan of reorganization or a step in such a plan under section 205 of Title 11, or fair and equitable to a railroad that is not itself in reorganization but which is leased, operated, or controlled by a railroad in reorganization;

(B) whether the transfers or conveyances are more fair and equitable than is required as a constitutional minimum; and

(C) what portion of the proceeds received by a railroad in reorganization from an entity other than the Corporation or any subsidiary thereof for the sale, lease, or transfer of property subject to an agreement under section 723 or section 725(a)(1) or (2) of this title reflects value attributable to the maintenance or improvement provided pursuant to the agreement.

(2) If the special court finds that the terms of one or more exchanges for securities, certificates of value and other benefits are not fair and equitable to an estate of a railroad in reorganization, or to a railroad leased, operated, or controlled by a railroad in reorganization (taking into consideration compensable unconstitutional erosion, if any, which the special court finds to have

occurred in the estate of each such railroad, during the bankruptcy proceeding with respect to such railroad) which has transferred rail properties pursuant to the final system plan, it may—

(A) enter a judgment reallocating the securities and certificates of value in a fair and equitable manner if they have not been fairly allocated among the railroads transferring rail properties to the Corporation or any subsidiary thereof, except that at least one share of series B preferred stock and one certificate of value shall be allocated to each such railroad; and

(B) if the lack of fairness and equity cannot be completely cured by a reallocation of the securities and certificates of value, order the Corporation to provide for the transfer to the railroad of other securities of the Corporation or certificates of value issued by the Association as designated in the final system plan in such nature and amount as would make the exchange or exchanges fair and equitable; and

(C) enter a judgment against the Corporation if the judgment would not endanger the viability or solvency of the Corporation.

(3) If the special court finds that the terms of one of more conveyances of rail properties to a profitable railroad operating in the region, State, or responsible person in accordance with the final system plan are not fair and equitable, it shall enter a judgment against such profitable railroad, State, or responsible person. If the special court finds that the terms of one or more conveyances or exchanges for securities, certificates of value or other benefits are fairer and more equitable than is required as a constitutional minimum, then it shall order the return of any excess securities, obligations, or compensation to the Corporation or a profitable railroad, State, or responsible person so as not to exceed the constitutional minimum standard of fairness and

equity. The special court shall also find the amount of the payments, if any, which each profitable railroad has made on behalf of a transferor railroad in reorganization in accordance with section 721(h) of this title, for which payment the profitable railroad has not been reimbursed, as provided in section 721(h) of this title. Notwithstanding any other provision of this paragraph or of paragraph (4), the special court shall order the return to any such profitable railroad from compensation deposited by such profitable railroad pursuant to subsection (a)(2) of this section, of any such amount so found together with interest at the rate provided in section 721(h) of this title. In making any finding under this paragraph, the special court shall take into consideration compensable unconstitutional erosion, if any, which it finds to have occurred in the estate of a railroad in reorganization in the region, or of a railroad leased, operated, or controlled by such a railroad, during the bankruptcy proceeding with respect to such railroad.

(4) Upon making the findings referred to in this subsection, the special court shall order distribution of the securities, certificates of value and compensation deposited with it under subsection (a) of this section to the trustee or trustees of each railroad in reorganization in the region and to persons leased, operated, or controlled by such railroads who sc transferred or conveyed rail properties who conveyed right, title, and interest in rail properties to the Corporation and the respective profitable railroads, States, and responsible persons under such subsection.

(5) Whenever the special court, pursuant to subsection (b)(1) of this section, orders the transfer or conveyance of rail properties—

> (A) designated under section 716(c) (1) (C) or (D) of this title, to the Corporation or any subsidiary thereof, the United States shall indemnify the Corporation against any costs or liabilities imposed on the Corporation as the result of any judgment entered against the Corporation,

with respect to such properties, under paragraph (2) of this subsection; and

(B) to the National Railroad Passenger Corporation, a profitable railroad operating in the region, a State, or any other responsible person (including a governmental entity), the United States shall indemnify such Corporation, railroad, State, or person against any costs or liabilities imposed thereon as the result of any judgment entered against such Corporation, railroad, State, or person under paragraph (3) of this subsection;

plus interest on the amount of such judgment at such rate as is constitutionally required. The United States may, in its discretion, represent the Corporation or the National Railroad Passenger Corporation, such profitable railroad, State or responsible person, in any proceedings before the special court that could result in such a judgment against the Corporation under paragraph (2) of this subsection or against the National Railroad Passenger Corporation, such profitable railroad, State or responsible person, under paragraph (3) of this subsection. The Corporation, the National Railroad Passenger Corporation, any profitable railroad, State, or responsible person, which is represented by the United States of America shall cooperate diligently in whatever manner the United States shall reasonably request of it in connection with such proceedings. Neither the Corporation, or its subsidiaries, nor the National Railroad Passenger Corporation, any profitable railroad, State or responsible person, shall be obligated to reimburse the United States for any moneys paid by the United States pursuant to this section.

(6) Whenever the Corporation exercises an option to acquire, or acquires, interests in rail marine freight floating equipment pursuant to the recommendations of the final system plan, and the Corporation thereafter makes such floating equipment available to a profitable railroad operating in the region, a

State, or a responsible person including a government entity,[2] the United States shall indemnify—

(A) the Corporation against any costs or liabilities imposed on the Corporation as the result of any judgment entered against it, with respect to such equipment, under paragraph (2) of this subsection; and

(B) such profitable railroad, State, or responsible person against any costs or liabilities imposed thereon as the result of any judgment entered against such profitable railroads, State, or responsible person under paragraph (3) of this subsection,

plus interest on the amount of such judgment at such rate as is constitutionally required.

(d) Appeal.—A finding or determination entered by the special court pursuant to subsection (c) of this section or section 306 of this title may be appealed directly to the Supreme Court of the United States in the same manner that an injunction order may be appealed under section 1253 of Title 28: *Provided*, That such appeal is exclusive and shall be filed in the Supreme Court not more than 20 days after such finding or determination is entered by the special court. The Supreme Court shall dismiss any such appeal within 7 days after the entry of such an appeal if it determines that such an appeal would not be in the interest of an expeditious conclusion of the proceedings and shall grant the highest priority to the determination of any such appeals which it determines not to dismiss.*

(e) Transfer and other taxes and recording fees.—All transfers or conveyances of rail properties (whether real, personal, or mixed) which are made under this chapter (including transfers and conveyances which are made in accordance with a supplemental transaction pursuant to section 745 of this title or which

* As amended by Pub. L. No. 95-199, § 4, 95th Cong., 1st Sess. (Nov. 23, 1977).

are made at any time to carry out the purposes of title VII of the Railroad Revitalization and Regulatory Reform Act of 1976 or of section 791(d) of this title) shall be exempt from any taxes, imposts, or levies now or hereafter imposed, by the United States or by any State or any political subdivision of a State, on or in connection with such transfers or conveyances or on the recording of deeds, bills of sale, liens, encumbrances, or other instruments evidencing, effectuating, or incident to any such transfers or conveyances, whether imposed on the transferor or on the transferee. Such transferors and transferees shall be entitled to record any such deeds, bills of sale, liens, encumbrances, or other instruments and, consistent with the designations and applicable principles in the final system plan, to record the release or removal of any pre-existing liens or encumbrances of record with respect to properties so transferred or conveyed, upon payment of any appropriate and generally applicable charges to compensate for the cost of the service performed.

Section 306, 45 U.S.C § 746, provides:

(a) General.—On the date when the Corporation is required to deposit securities with the special court pursuant to section 743(a)(1) of this title, the Association shall deposit with the special court the certificates of value of the Association required by this section. The Secretary shall guarantee the payment of all certificates of value delivered in accordance with this subchapter. All guarantees entered by the Secretary under this section shall constitute general obligations of the United States of America for the payment or redemption of which its full faith and credit are pledged. Such guarantees shall be valid and incontestable except as to mutual mistake of fact or as to fraud or material misrepresentation by the holder of such certificates or the transferor of rail properties to which certificates of value of any series so guaranteed are issued.

(b) Number and distribution.—A separate series of certificates of value shall be issued to each railroad in reorganization in the region and each person leased, operated, or controlled by such a railroad that transfers rail properties to the Corporation or a subsidiary thereof. The number of certificates of value of each series to be deposited pursuant to subsection (a) of this section shall be equal to the number of shares of series B preferred stock of the Corporation which are required to be deposited by the Corporation with the special court, pursuant to section 7439(a)(1) of this title in exchange for the rail properties transferred to the Corporation or a subsidiary thereof by such transferor. Certificates of value of the appropriate series shall be distributed by the special court, pursuant to section 743(c)(4) of this title, at the same time to the same transferors, and in the same numbers of units as shares of such series B preferred stock are distributed to such transferor.

(c) Redemption.—(1) Certificates of value, of any series, shall be redeemed by the Association on December 31, 1987, or on such earlier date as the Board of Directors of the Association and the Finance Committee jointly may determine and specify.

(2) Each certificate of value of each series shall be redeemable for an amount, payable in cash, equal to its base value on the redemption date, minus—

> (A) the sum of the fair market value of the series B preferred stock applicable to such certificate, the fair market value of the common stock applicable to such certificate, and all cash dividends theretofore paid on any such series B preferred stock and on any such common stock; and
>
> (B) any sums paid to a transferor of rail properties to whom such series of certificates of value was issued resulting from sales or leases by the Corporation of properties

transferred to it by such transferor divided by the number of certificates of value distributed to such transferor.

(3) The number of shares of series B preferred stock and common stock applicable to each certificate of value of any series, pursuant to paragraph (2) of this subsection, shall be—

(A) one share of series B preferred stock (adjusted to reflect any stock splits, stock combinations, reclassifications or similar transactions affecting the number of shares of outstanding series B preferred stock following the date of distribution pursuant to section 743(c)(4) of this title); and

(B) the number of shares of common stock determined by dividing the total number of shares of common stock distributed pursuant to section 743(c)(4) of this title to the transferor receiving such series of certificates of value (adjusted to reflect any stock splits, stock combinations, reclassifications, or similar transactions affecting the number of shares of outstanding common stock following the date of distribution pursuant to section 743(c)(4) of this title) by the total number of certificates of value in the series so distributed to such transferor.

(4) The base value of each certificate of value of any series shall be the value obtained by (A) taking the net liquidation value, as determined by the special court, to which the transferor to whom such series of certificates of value is issued is entitled by virtue of transfers of rail properties, under section 743(b)(1) of this title to the Corporation or a subsidiary thereof; (B) subtracting the value of other benefits provided under this chapter, as determined by the special court; (C) adding such amount, if any, as the special court may determine shall be required after taking into consideration compensable unconstitutional erosion, if any, in the estate of a railroad in reorganization, or of a railroad leased, operated, or controlled by such a railroad, which the

special court finds to have occurred during any bankruptcy proceeding with respect to such railroad; (D) adding interest from the transfer date to the redemption date to be compounded annually at a rate of 8 percent per annum; and (E) dividing the resulting value by the number of certificates of value of such series distributed to such transferor. In determining such base value, the special court shall give due weight and consideration to the finding of the Association as to the net liquidation value to which each transferor is entitled by virtue of conveyances of rail properties under section 743(b)(1) of this title. For purposes of this paragraph, the term "rail properties" includes all rights with respect to employee benefit plans transferred and assigned to the Corporation pursuant to section 743(b)(6) of this title. Net liquidation value with respect to such rights shall be determined after taking into account all obligations finally transferred or assigned to the Corporation pursuant to such section.

(5) The fair market value of series B preferred stock and of common stock of the Corporation shall be determined in accordance with regulations prescribed by the Association, on the basis of the average price of each such security in the primary established market in which such securities are traded over a period of 120 consecutive trading days ending not less than 20 nor more than 40 trading days preceding the redemption date, or in the case of a security for which there is not an established trading market, on the basis of the fair market value thereof as determined by the majority vote of three experts in the valuation of securities, one to be selected by the Association, one to be selected by the directors of the Corporation elected by the holders of the security to be valued, and one to be selected by the two first selected.

(d) Authorization for appropriations.—There are authorized to be appropriated to the Secretary such sums as are necessary to discharge the obligations of the United States arising under this section.

APPENDIX R

Appendix R

OFFICE OF THE CLERK
SUPREME COURT OF THE UNITED STATES
WASHINGTON, D.C. 20543

August 2, 1984

Dean R. May, Esq.
Carpenter, Bennett & Morrisey
744 Broad Street
Newark, New Jersey 07102

RE: *Central Jersey Industries, Inc., et al.* v. *United States Rrailway Association and United States, et al.*
No. ----

Dear Mr. May:

The Court today entered the following order in the above-entitled case:

"The statement of appellants as to dismissal of the appeal was received July 26, 1984 and presented to the Court for its consideration. The appeal from the Special Court, Regional Rail Reorganization Act of 1973, to review the final judgment entered July 23, 1984 shall not be dismissed at this time under Section 303(d) of the Regional Rail Reorganization Act of 1973. The time to docket the appeal is extended to and including September 21, 1984. The application for leave to file a statement as to jurisdiction in excess of the page limitations is granted provided the statement as to jurisdiction does not exceed forty pages. Justice Brennan took no part in the consideration or decision of this order."

Very truly yours,

ALEXANDER L. STEVAS, CLERK

By

Francis J. Lorson
Chief Deputy Clerk

gtb
cc: Honorable Rex E. Lee, Solicitor General
Lawrence Z. Sheikman, Esq.
James Davey, Esq., Clerk
Special Court (Misc. No. 76-1)

APPENDIX S

CA-900

Appendix S

SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed June 23, 1978, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER SECTIONS 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT

SECOND PRE-TRIAL ORDER

WHEREAS, in accordance with the First Pre-Trial Order, the Court has received the written submissions of counsel dated May 10, June 7, and June 15, 1978, and heard oral argument of counsel at a pre-trial conference on June 21-22, 1978; and

WHEREAS, the Court has determined that, in lieu of the procedure contemplated by the first ordering paragraph on page 5 of the First Pre-Trial Order, it should itself prepare this order;

NOW THEREFORE, it is ORDERED that:

(1) The Trustees of the Penn Central Transportation Company be, and they hereby are directed to submit to the Court and provide to the Government Parties and other transferors on December 1, 1978, their entire direct evidence (all of which shall be in writing) concerning the values that would have been received for dispositions of their properties for continued rail use in the absence of the Rail Act.

(2) All other transferors be, and they hereby are directed to submit to the Court and provide to the Government Parties and other transferors on December 31, 1978, their entire direct evidence (all of which shall be in writing) concerning the values that

would have been received for dispositions of their properties for continued rail use in the absence of the Rail Act.

(3) The Government Parties be, and they hereby are directed immediately to commence preparation, to the extent they have not already done so, of their evidence concerning the values that the transferors would have received for the disposition of their properties for continued rail use in the absence of the Rail Act.

(4) The Government Parties be, and they hereby are directed to submit to the Court and all other parties, on August 15, 1978, a detailed description of the rail use evidence which the Government Parties (a) have developed at that time and (b) insofar as practicable, which they intend to develop, concerning the values the transferors would have received in the absence of the Rail Act. Such filings shall identify studies and underlying materials upon which the Government Parties then intend to rely. Without limiting the generality of the foregoing, the Government Parties shall then advise the Court and all other parties whether and, if so, to what extent it will rely on studies relating to the anticipated performance of ConRail, on data concerning its actual performance, or on studies relating thereto, and, if it elects to do so, shall immediately undertake such further analysis as will be necessary to render such studies and data relevant to the issues here to be determined. The Government Parties shall also make a good faith effort in such submissions to address fairly and specifically the contentions contained in the transferors' May 10 Statements concerning the identity of the rail lines that would have remained in rail service in the absence of the Rail Act and the methodologies the transferors intend to use in determining the identity and values of those lines.

(5) The Government Parties be, and they hereby are directed to submit to the Court and all transferors, on August 31, 1978, a list identifying each document submitted on behalf of any transferor (or any creditor or stockholder interest therein) in any

reorganization court, Interstate Commerce Commission or Congressional proceedings affecting such transferor upon which the Government Parties then intend to rely in the trial of the rail use issues.

(6) The transferors be, and they hereby are directed to file on October 2, 1978, lists of the witnesses expected to testify in support of their affirmative cases, their qualifications, and a summary of the subject matter of their testimony.

(7) The transferors and the Government Parties be, and they hereby are directed to commence promptly and to complete by October 2, 1978, the exchange of basic data and related materials being used by witnesses who are expected to testify with respect to rail use.

(8) The transferors be, and they hereby are directed to provide the Court, the Government Parties, and each other, on October 2, 1978, with a supplementary statement which, insofar as feasible, shall make more specific their proposals concerning the likely acquirers of properties that they contend would have been acquired for continued rail use in the absence of the Rail Act. While the Court is not prepared to endorse the request of the Government Parties that all transferors should be required to join a single scenario describing a particular purchaser for each route segment, it continues to emphasize, as it did in its opinion of Oct. 12, 1977, see 445 F. Supp. at 1009, the desirability, from the standpoint of the transferors as well as of Government Parties and the Court, of the transferors' coming as close as possible to that goal. In these same filings each transferor shall indicate to what extent it intends to rely on evidence of "opportunity costs" as that term is defined in paragraphs (82) - (90) of the Statement of the Penn Central Trustees dated May 10, 1978.

(9) The Government Parties, to the fullest extent practicable, be, and they hereby are directed to submit, on January 31, 1979, the affirmative evidence (all of which shall be in writing) which

they intend to offer with respect to certain rail use issues which are in the nature of general affirmative defenses as distinguished from denials of the affirmative cases of the transferors. These issues include (a) the amounts that would have been required to rehabilitate the properties proposed for transfer; (b) the ability of private purchasers to finance the acquisition and rehabilitation costs of properties proposed for transfer to them; (c) the ability of public agencies and authorities to finance the acquisition and rehabilitation costs of properties proposed for transfer to them; (d) the legal power of public agencies and authorities to acquire such properties; (e) the extent to which the Interstate Commerce Commission would condition the acquisition of rail lines by profitable railroads upon those railroads' acquisitions of unprofitable lines; (f) the extent to which public agencies and authorities would insist upon receiving profits from other rail operations as a condition to their acquisition of properties; (g) the impact of labor protection obligations upon the values that the transferors would have received for their properties; (h) the impact that alleged breaches of executory contracts would have upon the values the transferors would have received for their properties; and (i) the "macroeconomic" conditions that would have affected the disposition process. Such submission shall include a witness list similar to that described in paragraph (6).

(10) In preparing their direct cases, the transferors (including the Trustees of the Erie Lackawanna) are entitled to assume that, in the absence of the Rail Act, serious consideration and discussion of dispositions for continued rail use would have begun not later than February, 1973. The direct cases shall contain evidence as to when the dispositions would have occurred. In preparing such evidence the transferors shall take into account the Court's observations in its CUE opinion, 439 F. Supp. 1351 (1977), with respect to the burden on transferors in showing that such dispositions would have taken place prior to April 1, 1976.

(11) As at present advised, the Court is not disposed to entertain argument that any transferor would have obtained a strategic advantage over other transferors (as distinguished from such advantages as ending of deterioration, entitlement to interests, etc.) by negotiating or consummating a disposition at an earlier date than other transferors.

(12) As at present advised, the Court believes that more rapid progress can be made by following in general the proposal of the Government Parties for a single trial encompassing all rail use issues than the proposals of various transferors for separate trials on separate issues; is not favorably disposed toward separation of the trials with respect to properties designated for intercity freight service and property designated primarily for passenger service; and is favorably disposed to the proposal that the trial with respect to what the Penn Central Trustees have termed "smaller, specialized properties" (May 10, 1978, Statement (4)) should be deferred until the basic network has been established. In consequence each transferor's direct case should identify such "smaller, specialized properties" but need not contain valuation evidence with respect thereto.

(13) The Court has given serious consideration to the request of the Trustee of the Central Railroad Company of New Jersey (CNJ) for a hearing independent of the hearing relating to transferors generally but has concluded that possible interrelationships between the cases of the CNJ and of other transferors make such a complete separation impracticable. However, arrangements will be made whereby any hearings with respect to CNJ (and other smaller transferors desiring such treatment) will be set for a specified date and such transferors will be given adequate notice of dates when testimony having special pertinence to their cases will be taken.

(14) After receipt of the transferors' direct cases the Government Parties shall promptly apply for such further discovery as they believe should be required. Such applications shall be made

as soon as practicable with respect to each witness and, in any event, shall be made no later than January 31, 1979. Any such request shall include an estimate of the time required for discovery. The transferors shall follow a similar procedure with respect to the evidence which the Government Parties are directed to furnish by paragraph (9) of this order, except that the final date for seeking discovery shall be March 5, 1979.

(15) To the maximum extent feasible, each transferor shall submit its direct rail use case in such form as will permit the Court to make necessary adjustments if it is persuaded by some but not all of a transferor's contentions. Alternatively, a transferor may submit a "maximum" and a "minimum" case. The Court will not view with favor any post-trial application by a transferor for leave to file a new direct case.

(16) The Court approves the suggestion, endorsed by almost all parties, that preparation for trial of non-rail use issues shall be deferred for the present. This is without prejudice to consideration of any new proposals that may be made on this score, see Penn Central Trustees' June 15, 1978 statement, p. 22.

(17) The Court considers it to be premature to deal at this time with the issues relating to masters outlined in the ordering paragraphs on pages 4 and 5 of the First Pre-Trial Order. It requests that the proposals directed by the penultimate paragraph of said order include the names of persons who might be available to serve as court-appointed experts under Federal Rule of Evidence 706 and shall take account of the availability of all persons suggested.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

June 23, 1978

Appendix S

IN THE SPECIAL COURT

REGIONAL RAIL REORGANIZATION ACT OF 1973

Filed June 12, 1981, James F. Davey, Clerk

Special Court—Misc. No. 76-1

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(C) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

SIXTH PRETRIAL ORDER

Whereas the Court has conducted proceedings relating to this order as outlined in its Memorandum and Order to Show Cause dated May 12, 1981, has held the hearing set therein for June 12, and has duly deliberated on the arguments of counsel for the transferors and the Government Parties (GPs);

NOW, THEREFORE, it is ordered that:

1. All parties shall proceed with maximum expedition to produce their entire direct cases relating to the realizable nonrail use value of all of the transferors' conveyed properties including those characterized in the Statement of the Penn Central Trustees dated May 10, 1978, paragraph (4), as "smaller, specialized properties". The cases shall include properties (which should be clearly identified) which transferors contend could have been sold for rail use at prices higher than they would have commanded for nonrail use. To the extent that this Court shall agree with such contentions, such properties can be eliminated at an appropriate time, except that if the Court finds that a property would have been sold at or at a percentage of or fixed dollar amount above or below value for nonrail use, it will remain essential to determine the latter figure.

2. All parties shall exert maximum efforts promptly to reach stipulations as to the inventory of the transferors' conveyed assets. Each transferor is directed to file a statement by July 15, 1981 identifying and describing with particularity each asset transferred pursuant to the Rail Act which has not been the subject of an inventory stipulation and for which the transferor claims nonrail use value.

3. The parties shall continue to attempt to reach stipulations concerning real estate values and other nonrail use values on which it appears that stipulations, particularly as to the base value of real estate and equipment unit values, should be attainable. The Court would expect this to be practicable with respect to all or nearly all equipment and most items of real estate. If any party believes that appointment of one or more special masters would facilitate the reaching of such stipulations, it shall promptly so advise the Court, with appropriate notice to the adverse party. The Court may take an unreasonable refusal to stipulate into account in assessing the costs of these proceedings.

4. Existing appraisals of real estate, facilities and equipment unit values that are intended to be offered in evidence shall be exchanged as soon as possible and discovery thereon shall be conducted on an accelerated informal basis.

5. Trial of the nonrail use value of the transferors' properties shall be on written direct evidence, subject to cross-examination in deposition format, in accordance with the procedures developed in the rail use phase of the case.

6. All parties are directed to submit proof as direct evidence rather than as rebuttal evidence to the maximum extent feasible. The Court will look with disfavor upon efforts by any party to hold back until the rebuttal stage of the nonrail use phase of the proceedings evidence that could have been produced and submitted as part of a party's direct case.

7. The transferors and the GPs shall submit their direct evidence on real estate base values not later than October 12, 1981. Such evidence includes adjustments for such factors as size, access, topography, zoning, location and title defects; it does not include such factors as glut, disposition costs, corridor premiums, discount for delay in disposition, and interim income. The parties shall also submit their direct evidence on unit values for facilities and equipment not later than October 12, 1981, again excluding such factors as glut, disposition costs, discount for delay in disposition, and interim income. The parties shall submit the balance of their direct cases not later than December 1, 1981 (including, with regard to lines kept in rail use but sold for a price based on non-rail use values, any adjustments for the perceptions of the parties negotiating or otherwise setting the sale price). If the Court's decision on the rail use phase of the case (or a summary thereof) shall not have been filed by November 2, 1981, evidence otherwise due December 1, 1981 shall be due on a date thirty days after such filing by the Court. In that event, subsequent dates will be adjusted accordingly. The Court does not anticipate this event.

8. At least fifteen days prior to each evidentiary submission, the parties shall file a statement that (a) lists all witnesses whose testimony will be submitted, (b) describes the issues on which each witness will testify, (c) identifies any other persons or studies providing material input for the witness' testimony and describes that input, and (d) states for each witness any dates within the cross-examination period when the witness will (for good reason) be unavailable for cross-examination. Any studies or materials relied upon by the witness' testimony should either be appended to the testimony or copies should be made available to opposing counsel at the time the testimony is submitted.

9. Immediately upon the filing of the statements described in § 8 of this order, the parties' Steering Committees shall meet and attempt to agree upon a joint proposal for a schedule for discovery

and cross-examination. The Court sees no reason why substantially all discovery, as distinguished from cross-examination, on the material directed to be submitted on October 12, 1981, cannot be conducted in the interval between October 12 and December 1. The schedule shall be so designed that cross-examination on the nonrail use phase of the case will be concluded by April 1, 1982.

10. All rebuttal evidence shall be submitted not later than May 15, 1982. The parties' Steering Committees shall thereafter proceed in a manner similar to that set forth in § 9 of this order. The schedule for discovery and cross-examination shall be so designed that cross-examination will be completed not later than July 15, 1982.

11. Each transferor shall be required to submit data only with respect to its own properties. If any party wishes to argue that sales of other properties, notably properties of Penn Central or of other transferors whose settlements have been approved prior to the dates set for submission, would have adversely affected the prices obtainable by a transferor, such party shall have the burden of presenting evidence with respect to the amount, time and pricing of such sales.

12. The request of CNJ for an exemption from the procedures herein made applicable to other transferors is denied.

HENRY J. FRIENDLY

Henry J. Friendly
Presiding Judge

JOHN MINOR WISDOM

John Minor Wisdom
Judge

ROSZEL C. THOMSEN

Roszel C. Thomsen
Judge

Dated: June 12, 1981.

APPENDIX T

Appendix T

Oral Opinion of the Honorable Anthony T. Augelli, *U.S.D.J.*, of March 26, 1971

IN THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

IN THE MATTER OF

CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. B 401-67

Newark, New Jersey

March 26, 1971

The Court: Because of the time element involved in this case, and the consequences of my decision, I think the parties involved in this application should know right now what conclusion I have reached.

As you know, I have been living with this case since its inception, four years ago. Some of the many problems involving this debtor were set out in an opinion I filed on November 2, 1970. Reference thereto is made for the Court's observations concerning the financial condition of the debtor, the need for money to continue operations, the dire consequences that would follow a cessation of operations, the impact such cessation would have on the economy of the State, and so forth.

After the conclusion of yesterday's arguments I again reviewed Mr. Timpany's affidavit of March 20th and the exhibits annexed thereto. Incidentally, those exhibits constitute the record that was presented to and considered by the Interstate Commerce Commission and the Secretary of Transportation in Washington.

Based on that record, the I.C.C. has approved the issuance of $6 million worth of Trustee's certificates and the Secretary of Transportation has guaranteed the payment thereof. The order of the I.C.C. and the findings of the Secretary have been marked in evidence in these proceedings as Exhibits T-1 and T-2, respectively.

In addition to the record just mentioned, I have reviewed my notes on the testimony given here by Mr. Stone, Mr. Young, Mr. Cogliati and Mr. Timpany. I have also examined Exhibits DMH-1, 2, 3, 4, 5 and 6 that have been marked in evidence.

Consideration has also been given to the Wyer-Dick report on the estimated liquidation value of the debtor's assets, which report was filed with the Clerk of this Court on June 25, 1970.

I again read the transcript of the hearings that were held before me on February 9th and 10th, at the conclusion of which I made an order authorizing the Trustee to apply to the I.C.C. and the Secretary of Transportation for Federal aid under the Emergency Rail Services Act of 1970.

The arguments made and the briefs of counsel have also been considered, as well as the cases cited therein. And, of course, I have had the benefit of the arguments made by counsel yesterday.

This issue before me at this time is whether the Trustee should now be permitted to issue the certificates that have been authorized by the I.C.C. and guaranteed by the Secretary of Transportation and use the money realized from the sale of such certificates for the continued operation of the debtor.

The application of the Trustee for authority to issue the guaranteed certificates is opposed by the Manufacturers Hanover Trust Company, the Indenture Trustee of the debtor's general mortgage securing some $42 million worth of bonds. Manufacturers is represented here by Mr. Ward.

Also opposed is the bondholders' committee, represented here by Mr. Goodstein. That committee holds some $17 million worth of the debtor's bonds.

Opposition to the application has also been voiced by the Lehigh Coal & Navigation Company.

In favor of the Trustee's application are the State of New Jersey, the labor unions that have been permitted to intervene in the reorganization proceedings, the Reading Company and the Carteret Industrial Association.

After consideration of the arguments pro and con, and the record before me, I have concluded to permit the Trustee to issue certificates for the full amount authorized by the I.C.C. and guaranteed by the Secretary of Transportation.

At the outset, let it be noted that the present Trustee of the debtor, Mr. Timpany, has only been in office since January 28, 1971. His qualifications as an experienced and capable railroad man are not challenged. Indeed, even those who oppose the present application concede that he is a knowledgeable and highly competent man in his field. And it is also worthy of note that the plan the Trustee has in mind for the rehabilitation of the debtor, and which is fully disclosed in the exhibits annexed to his affidavit, is not criticized by anyone as being impracticable. No fault has been found with what has been called here the Trustee's Blueprint For Survival.

Mr. Ward, speaking for the Indenture Trustee, and Mr. Goodstein, speaking for his committee, want the Trustee to succeed in his endeavors to rehabilitate this sick railroad.

Mr. Goodstein would be agreeable to the issuance of Trustee's certificates to the full $6 million authorized and guaranteed, provided, however, that as a condition to such issuance the Trustee be directed to file with the I.C.C. an application for abandonment of the debtor's present operation. From that point on, Mr. Goodstein argues, there should not be too much difficulty in working out an acceptable plan of reorganization of the debtor.

The effect that total—or even partial—abandonment of operations would have on the labor situation is one of the factors that must be considered in the over-all evaluation of a feasible plan of reorganization.

The Indenture Trustee argues vigorously that the debtor has no chance of becoming a self-sustaining operation. It points to past performance and uses that as a base for its pessimistic conclusion.

Adding $6 million worth of new debt to the present financial structure of the debtor, which new debt would enjoy a priority over the lien of the mortgage, would, it is argued, constitute an unconstitutional taking of the bondholders' property, a taking in violation of the due process and just compensation clauses of the Fifth Amendment.

If the debtor is not to be shut down—and the Indenture Trustee expressly states that it does not want this happen, if it can possibly be avoided—it is suggested that the Trustee might look elsewhere for money—perhaps the State of New Jersey; perhaps the shippers; perhaps other sources could be found that would be willing to advance funds, without, of course, impairing the present priority in lien that is enjoyed by the bondholders. But the naked fact is that there are no such sources presently available.

In considering the Trustee's present application I have not lost sight of the fact that the Indenture Trustee has filed with the Court a petition for dismissal of the reorganization proceedings pursuant to Section 77(c) of the Bankruptcy Act. That petition, with the consent of the parties concerned, was referred to the Interstate Commerce Commission for consideration and recommendation as to whether or not the proceedings should be dismissed.

It is argued that pending disposition of that application the Trustee should not be authorized to incur a new debt, because if the reorganization proceedings are dismissed, the debtor's estate will be returned to its board of directors, presumably for the purpose of liquidation.

I find no merit to this argument. What disposition will be made of the dismissal application cannot be known at this time. And when a decision in that matter will be reached is likewise a question that cannot now be answered.

The Trustee has testified that present funds will permit operation of the debtor into the month of April. And we know that when the money that is now in the till runs out the wheels will stop turning. If I were to deny the Trustee's application to issue the guaranteed certificates, operations would cease, for lack of cash, and the application referred to the I.C.C. would become moot. In effect, I am being asked to decide at this time the same issues referred to the I.C.C. on the dismissal petition filed with me by the Indenture Trustee.

It is argued that the legal standards for authorizing the issuance of Trustee's certificates set forth in Section 77(c)(3) of the Bankruptcy Act have not been met by the Trustee in this case. A reading of that Section of the Bankruptcy Act, and the cases cited in both briefs, satisfy the Court that the statutory requirements have been fully met. Good cause has been shown for the issuance of such certificates—either they issue or we stop operating; that the issuance of such certificates for the purpose of assuring the continued operation of the debtor is a lawful purpose; and that such certificates may be granted priority is a matter that is not open to question.

Moreover, the I.C.C. has made a specific finding that the issuance of the $6 million worth of Trustee's certificates here involved is for a lawful object and is compatible with the public interest. That finding, while it might not be binding on me, is nevertheless entitled to some consideration.

I likewise find no merit in the argument that the issuance of the Trustee's certificates in this case will result in an unconstitutional taking of the bondholders' property. In support of this argument the Indenture Trustee leans rather heavily on the Wyer-Dick report, which sets forth the estimated liquidation value of the debtor's assets. That report shows that as of June 30, 1968, the estimated net liquidation value of all of the debtor's assets was $79,654,000.

But I cannot accept that figure for the purposes of the Trustee's present application. The reason therefor is made clear by the

report itself. It is stated therein that the liquidation value of $79,654,000 is a theoretical or hypothetical value, because it is based upon the assumption that all of the physical facilities of the debtor would be removed, and that all of the customers served exclusively by the debtor would be deprived of rail service. The report goes on to say that a more realistic value would be obtained if certain lines and terminal facilities would be candidates for purchase by other railroads.

With respect to the physical properties of the debtor, as to which only scrap value was assigned, the report points out that such value was based on the extremely low level of scrap prices prevailing as of June 30, 1968. The report, which was completed in June of 1970, states that on the basis of October, 1969, price levels the estimated liquidation value would be increased by a minimum of $900,000, and that the level of scrap prices was even higher as of the date of the report in June of 1970.

When the Wyer-Dick report is viewed in light of Mr. Timpany's testimony, and his Blueprint For Survival, I think it is obvious that the Indenture Trustee is leaning on a very weak reed.

In further support of its argument that there will be an impermissible taking of bondholders' property, the Indenture Trustee assumes that the money borrowed on the guaranteed certificates will be irretrievably lost when used by the Trustee in furtherance of his plan for the reorganization of the debtor. The Indenture Trustee has not satisfied this Court that such results will necessarily follow. Reliance is placed on an examination of the debtor's records made by the accounting firm retained by the Indenture Trustee. Data secured by the accountants is reflected in Exhibits DMH-1, 2, 3, 4, 5 and 6.

The sum and substance of the testimony given with respect to these exhibits by Mr. Stone and Mr. Cogliati is that the debtor is a dead railroad and that there is no real hope of achieving viability.

There is no question about the fact that projections and assumptions abound in this case. In balancing all of the evidence

adduced on behalf of the bondholders against what has been termed the hopes and aspirations of the Trustee, this Court finds that the so-called hopes and aspirations of the Trustee are based on a pretty solid factual foundation, and that there is every likelihood that, aided by the infusion of the $6 million, the Trustee will come up with and acceptable plan of reorganization within a reasonable period of time.

Even if it be assumed that the issuance of the guaranteed certificates would result in a dilution of the bondholders' security, such dilution would not necessarily be unconstitutional. The rights of bondholders are not absolute. The interests of the public must be considered as well as theirs.

And in this connection, while the cases are long cases, I suggest a careful reading of the New Haven inclusion cases, reported in 399 U.S. 392; the Penn Central merger cases, reported in 389 U.S. 486; and the Continental case, reported in 294 U.S. 648.

I am familiar, of course, with the Central Railroad case, reported in 421 F. 2d 604. But I do not believe that has any application to the matter now before me, nor do I believe that that is the law of this case.

The case of In Re Prima, reported in 88 F. 2d 785, in my opinion is clearly distinguishable.

And I am familiar with the several opinions handed down by Judge Anderson in connection with the reorganization proceedings involving the New Haven. However, as we know, the New Haven was finally taken over by the Penn Central. The story of that take-over, of course, is told in the New Haven inclusion cases, the citation of which cases I have already mentioned. Judge Anderson did not have to reach the decision as to whether or not there had been an unconstitutional taking of bondholders' property.

And I know that counsel are familiar with Judge Fullam's opinion in the Penn Central reorganization proceedings, wherein the New Haven Trustees' objection to the issuance of Trustee's certificates in that case was overruled.

The Third Avenue case, reported in 198 F. 2d 703, is not strictly a Trustee's certificate case. Hence, I do not think it is relevent in this matter.

In its brief the Indenture Trustee agrees that if the expenditure of funds to defray operating expenses buys time, during which the debtor's finances can be reorganized and stabilized, and thereby eliminate the necessity for involuntary liquidation, the risk to creditors' interests posed by a forced reordering of priorities would be minimized, and this Court might properly authorize the issuance of the guaranteed certificates.

Based on the record in this case, I have no difficulty in concluding that a utilization of the proceeds of the sale of the guaranteed certificates to defray operating expenses will give the Trustee a much needed breathing spell and time within which to formulate an acceptable plan of reorganization.

I find that the Trustee has demonstrated that, with the help of the new money, a successful reorganization of the debtor is indeed feasible and that such reorganization will be effected within a reasonable time.

And I want to stress that even if the issuance of the guaranteed certificates did result in some dilution of the bondholders' present security position, I would still feel obliged, in the exercise of my discretion, to grant the Trustee's application. The basic argument against the issuance of the Trustee's certificates is that there is no present assurance that a successful reorganization can be effected. The opposing parties have not only failed to satisfy the Court that the debtor cannot be successfully reorganized, but there has also been a failure of proof that the $6 million put into operations will go down the drain and be lost.

The exhibits annexed to Mr. Timpany's affidavit of March 20th, as I said before, are the record that resulted in the exhibits that have been marked in evidence here as T-1 and T-2; those exhibits speak for themselves. The I.C.C. has authorized the Trustee to issue $6 million worth of certificates, finding that the

issuance is for lawful purpose and compatible with the public interest.

The Secretary of Transportation, after consultation with the I.C.C., has guaranteed the certificates and has made the requisite findings of face required by Section 3(a) of the Emergency Rail Services Act of 1970.

The findings of the I.C.C., with its expertise, and the findings of D.O.T., with its expertise, are certainly entitled to some weight. And certainly no evidence has been produced before me that would militate against the findings made by the Secretary of Transportation: (1) that cessation of essential transportation services by the debtor would endanger the public welfare; (2) that such cessation of services is imminent; (3) that there is no other practicable means of obtaining funds to meet payroll and other expenses necessary to provide such services than the issuance of the certificates; (4) that such certificates cannot be sold without a guarantee; (5) that the debtor can reasonably be expected to become self-sustaining; and (6) that the probable value of the debtor's assets, in the event of liquidation, provide reasonable protection to the United States.

It is my independent judgment that each of the foregoing findings find ample support in the record that is before me in these proceedings. Mention was made by Mr. Goodstein of a condition relating to Finding No. 5 of the Secretary of Transportation. It reads as follows:

"Accordingly, as a condition to a guarantee, the Trustee will be required to undertake diligent efforts to implement the plan according to a specified and strict time schedule."

It is my opinion that this condition is not to be construed as in any manner affecting the marketability of the guaranteed certificates. In other words, it should be clearly understood that when the guaranteed certificates are sold there are no hidden gimmicks anywhere that would affect the marketability of such certificates or their guarantee by the Secretary.

One final note: I have read and re-read the Trustee's Blueprint For Survival. Even without the specific findings made by the Secretary of Transportation, I would have no hesitancy in permitting the issuance of Trustee's certificates in this case, after authority for their issuance has been obtained from the I.C.C. The Trustee's program for the rehabilitation of this debtor is, in my opinion, a sound program and entirely feasible. Certain unprofitable operations are to be discontinued. The prospects are more than promising that the negotiations presently under way will result in a decided improvement in the condition of this debtor.

Schedule B of the exhibits annexed to the Trustee's affidavit outline what may reasonably be expected to happen in this case. Of course, assumptions are made. But those assumptions, in my opinion, have substance.

What is the alternative to the program that is offered by the Trustee? As I see it, a denial of the Trustee's present application means the end of all operations. I firmly believe that the new Trustee entitled to every opportunity to bring his plan to fruition. The public interest should not be sacrificed solely to protect the interest of the bondholders.

I am in full agreement with the principle that bondholders should not be asked to finance a railroad operation that is doomed to failure. But, in my opinion, we do not have that situation here. There is a good chance that with the changes proposed to be taken by the Trustee the debtor will emerge as a viable railroad.

For the reasons that I have stated, the application of the Trustee will be granted to the extent of the $6 million worth of Trustee's certificates authorized by the I.C.C. and guaranteed by the Secretary of Transportation. Withdrawal of funds resulting from the sale of certificates will only be allowed on the Trustee's petition setting forth the amount to be drawn down and the reasons for such withdrawal. Those applications for withdrawal of funds, of course, will be made on notice to all parties in interest and will be subject to approval by this Court.

Gentlemen, I realized that I have given a rather rambling opinion here. But I did not want to delay matters. If an appeal is to be taken from my decision, I would appreciate it if counsel would let me know so that I may edit what I have said here orally and make more specific the reasons why I have granted the Trustee's application.

Mr. Weiss, you will please submit an appropriate order.

Appendix T

Oral Opinion of the Honorable Anthony T. Augelli, *U.S.D.J.*, of December 8, 1972

IN THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

IN THE MATTER OF

CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. B 401-67

Newark, New Jersey

December 8, 1972

The Court: Because of the public interest in this matter and the newspaper publicity that the hearing here has received, I have decided to make known my decision today.

Number 1, I have decided preliminarily that I do have the power to grant the relief.

Number 2, the bondholders will not be precluded by the doctrine of collateral estoppel.

And I might say I am familiar with the mortgage indenture. I am familiar with the Wyer, Dick valuation study. And, of course, for five years I have lived with this case—a little over five years. I know all of the operating losses and the difficulties that the railroad has encountered in its operations. I can appreciate, also, that it does need more money if it is going to operate its passenger services at less than the tremendous losses being incurred today on the basis of an avoidable loss contract.

But I am afraid that on the basis of the present record I cannot give the bondholders the relief they seek, namely, that I shut

down total operations of the Central Railroad Company of New Jersey on some date to be fixed by me.

I think that is a drastic step and one that should only be taken on a sufficient record.

I have in mind that on December 11 I will be confronted with another application, and this by the trustee. In his petition he asks for an Order authorizing him to terminate the current subsidy contract with the State of New Jersey as of December 31, 1972, and at that time to terminate all passenger service of the debtor as of 11:59 p.m. on that date, unless prior thereto the State of New Jersey and the trustee—Mr. Timpany—enter into a full cost of service passenger subsidy agreement.

What I will do with that one, of course, I don't know. And my dismissal of Mr. Ward's application at this time is without prejudice to his coming into that proceeding, if he wishes to.

I do think that we have shown some improvement. We have got a long way to go. but I don't think that as of yet the assets of this estate have so eroded that the constitutional line has been passed, where there has been a taking of the bondholders' property in violation of the Fifth Amendment. I don't think we have reached that point yet.

That is not to indicate that we might not reach it. But I am deciding the application that is pending before me on the basis of the present record.

We cannot lose sight of the fact that some progress has been made and that conditions subsequent to March of 1971 have helped rather than hindered the estate, and consequently those who hold security interests in the estate.

In Judge Anderson's opinion, the one reported in 281 F. Supp. 65, there is laid down this rule, or this statement made by the ICC, and approved by the Supreme court in its New Haven inclusion opinion, approving the Penn Central merger. And that statement reads as follows—it is on page 67:

> "It is a fundamental aspect of our free enterprise economy that private persons assume the risks attached to their investments and the New Haven creditors can expect no less because the New Haven's properties are devoted to a public use."

Then Judge Anderson goes on to quote Justice Fortas' opinion. Justice Fortas was then speaking for the majority. And he said that while the rights of the bondholders are entitled to respect, they do not command Procrustean measures.

I used the word "drastic" instead of "Procrustean."

I think we have got to be realistic. and I, for one, am not going to permit this railroad to continue operating to the detriment of anybody—bondholders or anyone else. I do think the public interest must be served. And I think it will be served by a continuation of service, at least for the time being.

We have had some changes here, and they are all changes that I think are very beneficial, and will be of benefit to the estate generally. And I have reference to a few of them that were mentioned here.

One is the Liberty Park deal, where there is a lease of 17 acres in that area. There was also a $10 million figure thrown around—negotiations on the sale of the property. Whether that will materialize—apparently it is not enough, because Mr. Wachenfeld has some litigation concerning that particular property.

We have the layoff of the employees. An unfortunate thing, but nevertheless necessary. Sometimes drastic action must be taken. I have always said that I wished that there was more cooperation between the labor force and management in this particular railroad. I always thought that work rules should have been changed long, long ago. But we finally did. We finally reached the situation now where we have made some drastic changes in the work rules that are going to be very beneficial.

And you have got the decrease in personnel. That is going to be very helpful.

There has been a profit increase on the use of their cars from $102—my notes show—to $130. These figures are not exact.

Then we have the bad order cars that were leased to Rock Island on a per diem basis. That is bringing in income.

Of course, we have the subsidy contract with the State of New Jersey, which pours in—whatever it does—not enough, but still—I think there were two drawdowns. There is still a balance of some $5 million, is there, due by June of 1973?

Mr. Ward: Two million, your honor.

The Court: Two million. there have been advances, that's why.

We know we have the DOT behind us, to a certain extent. And I might say right now that $900,000 should be made available, Mr. Sharfman, right away quick.

Yes?

Mr. Sharfman: It will be, your Honor.

The Court: Then we have the Elizabeth lease, the Port leases; the possible joint use, or use in common of a bridge, and the sale of a bridge for four million something; the trailer container facility.

And I could go on with a few others. but you all heard what they are. But they are all indications, they are all activity, they all indicate that improvement is being made, that the condition of the railroad is not too bad, insofar as the bondholders; security is concerned.

It may be that there will be changes. And I don't doubt that there will be. And I think we are going to reach the point very soon—not too far away—where this Court is going to make a determination that either this railroad keeps on rolling along or we are going to shut the whole kit and kaboodle down. All I am deciding today is that on the basis of the present record I cannot grant the relief sought by the bondholders. And that denial is made without prejudice. It may be that the bondholders will

want to give a look at what happens on December 11 and then govern themselves accordingly.

You will now submit an appropriate Order, Mr. Weiss. And that is it.

Mr. Weiss: Thank you, your Honor.

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No. 84-450

In the Supreme Court of the United States

OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC., ET AL., APPELLANTS

v.

UNITED STATES RAILWAY ASSOCIATION, ET AL.

ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

MOTION OF THE FEDERAL APPELLEES TO AFFIRM

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QUESTIONS PRESENTED

1. Whether the Special Court correctly held that, because appellants' properties had no earnings value in rail use, the market value of those properties for purposes of just compensation is determined by their liquidation value for nonrail use.

2. Whether the Special Court correctly held that the 8% per year compound interest rate prescribed in the Rail Act, which was equal to the interest rate appellants could have obtained as of the conveyance date on government obligations of appropriate duration, provides just compensation.

3. Whether the Special Court correctly held that the costs of removing a bridge, which were not caused by the Rail Act and would have been incurred in the absence of that Act, do not constitute compensable severance damages.

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In the Supreme Court of the United States

OCTOBER TERM, 1984

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IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC., ET AL., APPELLANTS

v.

UNITED STATES RAILWAY ASSOCIATION, ET AL.

ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

MOTION OF THE FEDERAL APPELLEES TO AFFIRM

Pursuant to Rule 16.1 of the Rules of this Court, the United States, the Department of Transportation, and the United States Railway Association move that the judgment of the Special Court be affirmed.

OPINIONS BELOW

The opinions of the Special Court are enumerated at J.S. 1-2.

JURISDICTION

The judgment of the Special Court (J.S. App. 863-869) was entered on July 23, 1984.[1] Notices of appeal were filed on July 30, 1984 (J.S. App. 870-883). On August 2,

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[1] In this motion we shall follow our usual format of referring to the appendix to the jurisdictional statement as "J.S. App." rather than adopting appellants' designation of the appendix as "C.A."

1984, this Court ordered (J.S. App. 899) that the appeal not be preliminarily dismissed under 45 U.S.C. 743(d), which provides for dismissal if "such an appeal would not be in the interest of an expeditious conclusion of the proceedings." See page 15 note 15, *infra*. Pursuant to an extension of time granted by the Court in its order of August 2, the jurisdictional statement was filed on September 21, 1984. The jurisdiction of this Court is invoked under 45 U.S.C. 743(d).

STATEMENT

This case involves the valuation of properties transferred to the Consolidated Rail Corporation (Conrail) and others pursuant to the Regional Rail Reorganization Act of 1973, 45 U.S.C. 701 *et seq.* (Rail Act). Appellants are Central Jersey Industries, Inc. (CJI), the successor in reorganization to the Central Railroad Company of New Jersey, and six affiliated companies;[2] prior to the transfer of their properties, appellants were part of a single rail system operating as the Central Railroad of New Jersey (CNJ). Appellants challenge the valuation of their transferred property by the Special Court, Regional Rail Reorganization Act (see 45 U.S.C. 719(b)), under Sections 303(c) and 306 of the Act, 45 U.S.C. 743(c) and 746. Appellants are the only transferors that have not settled their claims for compensation under the Act[3] and thus are affected by the decision below.

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[2] The six affiliated companies of CJI are Bay Shore Connecting Railroad, Central Railroad Co. of Pennsylvania, Dover and Rockaway Railroad Co., Mt. Hope Mineral Railroad Co., Wharton and Northern Railroad Co., and Communipaw Central Land Co.

The other parties to the proceedings below were (1) appellees United States, United States Department of Transportation, and United States Railway Association (the government parties or federal appellees), (2) Conrail, and (3) numerous other transferors and transferees of rail properties under the Rail Act and persons permitted to intervene; these other parties and intervenors are listed in the Appendix hereto, *infra*, 1a-5a.

[3] See J.S. 3; *CNJ Opinion*, 571 F. Supp. 1201, 1279 (J.S. App. 681). (We have followed the convention, used by the court below and

1. *Statutory background.* Section 306 of the Rail Act provides that transferors of rail property to Conrail are to be compensated with "certificates of value," issued by the United States Railway Association (USRA, see Sections 201 *et seq.*, 45 U.S.C. 711 *et seq.*) and guaranteed by the Secretary of Transportation, constituting "general obligations of the United States of America for the payment or redemption of which its full faith and credit are pledged" (§ 306(a), 45 U.S.C. 746(a)).[4] The certificates of value are to be redeemed by USRA on December 31, 1987, or such earlier date as USRA may specify, at a price equal to "the net liquidation value" of the properties conveyed to Conrail (decreased by the value of other benefits provided by the Rail Act and increased by any compensable unconstitutional erosion suffered by the transferor) plus interest at 8% per year, compounded annually, from the transfer date of April 1, 1976, to the time of redemption (§ 306(c), 45 U.S.C. 746(c)).[5]

The Rail Act creates a three-judge district court, designated as the Special Court (see § 209(b), 45 U.S.C. 719(b)), to determine the net liquidation value of the conveyed properties (as adjusted, where appropriate, for

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appellants in their jurisdictional statement, of referring to the opinions of the Special Court in this case by an abbreviated form of citation (see J.S. 1-2).)

[4] The Rail Act originally provided that the transferors were to be compensated with securities of Conrail and USRA obligations (§ 303(a) and (c), 45 U.S.C. (Supp. V 1975) 743(a) and (c)). The Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, § 610(b), 90 Stat. 100, created the certificates of value as a medium of compensation. In 1981, in connection with the plan to sell Conrail to private interests, Congress eliminated the Conrail securities from the compensation scheme. Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, § 1167(b), 95 Stat. 686. See *Severance/Delay Damage Opinion*, 591 F. Supp. 651, 655-656 (J.S. App. 819-821).

[5] CNJ and the government parties stipulated that the components of value arising from other benefits and compensable unconstitutional erosion were zero. See J.S. 8 n.12; *Severance/Delay Damage Opinion*, 591 F. Supp. at 653 (J.S. App. 817); *Final Judgment re Central Railroad Co. of New Jersey* at 3-5 (J.S. App. 864-866).

other elements of value and interest) under Section 306(c) and to decide whether the compensation provided to the transferors was "fair and equitable" and not "more fair and equitable than is required as a constitutional minimum." § 303(c), 45 U.S.C. 743(c). The Special Court, consisting of Circuit Judges Friendly and Wisdom and District Judge Thomsen, conducted all of the valuation proceedings during the eight-year life of this litigation.

2. *The relationship of constitutional minimum value, net liquidation value, and the certificates of value.* Early in the proceedings below, all parties took the position, accepted by the Special Court, "that the fair and equitable standard of § 303(c)(1)(A) requires the 'just compensation' mandated by the Fifth Amendment, neither less nor more." *Severance/Delay Damage Opinion*, 591 F. Supp. 651, 655 (J.S. App. 819). Following extensive briefing and oral argument, see *CMV Opinion*, 445 F. Supp. 944, 999 (J.S. App. 167), the Special Court set forth certain principles to govern the determination of the transferors' rights to compensation under this coextensive standard.[6] The court held that the net liquidation value of the conveyed properties could be measured by the greater of the amounts realizable from (1) a sale to others for continued rail use, or (2) a piece-by-piece sale of the assets following cessation of operations and dismantlement. *Id.* at 1004-1011 (J.S. App. 177-190).[7] The court then explained:

> [T]he usual meaning of the Fifth Amendment's just compensation clause is that the taker must pay the market value of the property, without considering its

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[6] In addition, the court rejected challenges to the use of certificates of value, ruling that cash payment was not required by the Constitution. 445 F. Supp. at 999-1004 (J.S. App. 168-176), citing *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 150-156 (1974).

[7] The court made clear that the term "liquidation" encompassed "all available methods of disposition" and was not limited to scrap. 445 F. Supp. at 1004 (J.S. App. 177); see also *Rail Use Opinion*, 531 F. Supp. 1191, 1213 n.23 (J.S. App. 592 n.23).

> own presence in the market. In these circumstances, that rule would value each transferred property at the higher of scrap value or its sales value to parties other than the United States.

Id. at 1016 (J.S. App. 199). Accordingly, the compensation to be awarded was to be determined by what a transferor could have done, in the absence of the Rail Act, to realize value from its properties. Unless it yielded a "manifestly unfair result," this net liquidation value would satisfy all constitutional requirements. *Id.* at 1029, 1030, 1045 (J.S. App. 226, 227-228, 258).[8]

3. *Determination of which properties could have been sold for continued rail use.* The Special Court divided the evidentiary proceedings between "the rail and nonrail use phases of the case." *Rail Use Opinion*, 531 F. Supp. at 1202 (J.S. App. 279). In the rail use phase, the court heard evidence[9] regarding sales of properties for con-

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[8] The court thus considered and reserved the transferors' claim that net liquidation value might not provide constitutionally adequate compensation. In later entering final judgment in appellants' case and approving settlements covering the other transferors, the court determined that net liquidation value satisfied the constitutional standard. See *Final Judgment re Central Railroad Co. of New Jersey* at 2, 4-6 (J.S. App. 864, 866); *e.g.*, *Order Approving Penn Central Agreement* (Dec. 5, 1980), slip op. 3-5.

[9] Throughout the proceedings, all direct evidence was submitted in written form, and all cross-examination was conducted by deposition. This procedure eliminated "what had been expected to be the need for a multitude of special masters" and permitted "as many as a half-dozen cross-examinations simultaneously." 531 F. Supp. at 1202 (J.S. App. 279). In the rail use phase of the proceedings, almost 300 witnesses testified by affidavit or deposition and, despite the intervening settlement with Penn Central, 29 volumes of briefs, plus record appendices, were filed. While not all of this evidence and argument directly addressed appellants' claims, much of it was relevant to CNJ's case in light of "the dependence of each [transferor's] prospects upon what would have become of other [transferors] in the absence of the Rail Act, as well as the substantial overlap of issues across the claims of various [transferors] * * *." *Id.* at 1204-1205 (J.S. App. 283); see also *id.* at 1205, 1294 n.178, 1367-1368 (J.S. App. 284, 624, 558-559).

tinued rail use in the absence of the Rail Act and the prices that would have been paid for those properties based upon earnings value. In addition, "certain lines would have been kept in rail use for reasons other than their earnings power * * * [at] prices based in whole or in part with reference to nonrail use or scrap value." *Id.* at 1202-1203 (J.S. App. 279).

The long procedural history of the rail use phase is recounted by the Special Court in its *Rail Use Opinion*, 531 F. Supp. at 1201-1204 (J.S. App. 277-283). In early 1981, just prior to the submission of the parties' opening briefs, settlements were reached with the largest transferor, Penn Central, and with Lehigh & Hudson River. Between oral argument in June 1981 and the Special Court's announcement of its findings and conclusions in the rail use phase, settlements with the Reading Company, Erie Lackawanna, and several other transferors were also achieved.

In its *Rail Use Opinion* of November 24, 1981, the Special Court accepted virtually all of the transferors' claims regarding the lines that would have been sold for continued rail use. See 531 F. Supp. at 1212, 1346, 1364, 1379 (J.S. App. 296, 524, 554, 578-579). But the court held that competition among prospective buyers would have been necessary to raise the ultimate purchase price above scrap values. "[I]n the single-buyer situation the seller would not receive much over * * * what the buyer would have perceived the seller's likely receipts from dismantling or condemnation to be." *Id.* at 1220 (J.S. App. 310). Thus, when public bodies acquired rail lines for continued use because of their value to the public rather than their capacity to generate earnings, "the prices * * * [they] would have been willing to pay * * * would have been negotiated with reference to the value of [a transferor's] next best alternative." *Id.* at 1324 (J.S. App. 488).

CNJ did not claim that any of its rail lines had earnings value and thus that, under general principles, it could have sold them for continued rail use based on earnings. However, it did contend that, prior to the de-

cisions upholding the constitutionality of the Rail Act,[10] the State of New Jersey had in fact been "on the verge of buying CNJ's entire system," *Rail Use Opinion*, 531 F. Supp. at 1378 (J.S. App. 577), at a price that allegedly had been negotiated in July 1974 on the basis of certain valuation studies. *Id.* at 1209, 1374 (J.S. App. 291-292, 570). The Special Court rejected this argument on the facts (see *id.* at 1375 (J.S. App. 571)), finding that the "substantial uncertainty as to the sale price and properties to be included in the transaction" (*id.* at 1378 (J.S. App. 576)) precluded any determination that the court decisions upholding the constitutionality of the Rail Act cut off "an actual, probable sales opportunity." *Id.* at 1375 (J.S. App. 571).

The Special Court also considered CNJ's alternative argument that, apart from these actual negotiations, the State would not have been willing, in the absence of the Rail Act, to permit CNJ's lines to go out of service. The court agreed with this contention, concluding that "[i]n the absence of any prospect of private acquisition * * * it [was] likely that New Jersey would have intervened to save CNJ's * * * rail properties for continued rail use." *Rail Use Opinion*, 531 F. Supp. at 1379 (J.S. App. 578). Because there would have been no competitive bidding, however, the sale "would have taken place at a price equal to what we have called X" (*id.* at 1382 (J.S. App. 584)), which represented the scrap or nonrail use value of the lines to be determined in the second phase of the proceedings. See *id.* at 1213 (J.S. App. 298).

4. *Determination of the amount of scrap or nonrail use values.* In the next phase of the proceedings, the Special Court turned to consideration of scrap or nonrail use values that would have set the purchase price for the sale of CNJ's and other transferors' lines in the absence of the Rail Act. Shortly after the submission of the parties' written direct evidence on nonrail use values,

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[10] *In re Penn Central Transp. Co.*, 384 F. Supp. 895 (Sp. Ct. R.R.R.A. 1974)); *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974).

settlements in principle were reached with two major transferors, Lehigh Valley and Ann Arbor, leaving only appellants and a related entity, the Lehigh & New England Railway Co., to litigate the remaining issues.[11]

In its *CNJ Opinion* of July 12, 1983, the Special Court considered and rejected, on the facts presented, CNJ's theory that, but for the Rail Act, the State of New Jersey would have offered a purchase price in the fall of 1974 based on the valuation studies cited by CNJ. 571 F. Supp. at 1284 (J.S. App. 689-690). Among other matters, the court noted the "wide disparity" between the values one of the studies had placed on certain parcels of real estate retained by CNJ and the prices actually paid by the State of New Jersey when it acquired those same properties (independently of the Rail Act) after 1976. *Ibid.*

The Special Court then made detailed findings as to the manner in which the State, as the likely purchaser of CNJ's lines in the absence of the Rail Act, would have determined the nonrail use value of appellants' conveyed properties.[12] The parties were able to agree upon the required calculations of those values, following the principles set forth by the court in the *CNJ Opinion*, for all but a few assets. The Special Court resolved these remaining differences in December 1983 in its *Memorandum Accompanying Judgment Under § 306(c)(4) of the Rail*

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[11] The Special Court noted that "[e]ven with the scope of the proceeding thus reduced, a formidable record has been compiled. The statements of witnesses and appendices for the CNJ and L&NE comprise 5154 pages; those for the [government parties] 3368; and 17,435 pages of depositions were taken. The [government parties'] opening and reply briefs contain 786 pages; the CNJ's and L&NE's 741." *CNJ Opinion*, 571 F. Supp. at 1279 (J.S. App. 681).

[12] Following the Special Court's *Opinion on Petitions for Reconsideration of CNJ Opinion* in September 1983, 571 F. Supp. at 1335 (J.S. App. 792), which contained minor modifications of the court's findings with regard to nonrail use value, an agreement in principle was reached to settle the claims of Lehigh & New England Railway Co. Thus, only appellants' claims to compensation for properties conveyed under the Rail Act remained unsettled.

Act (J.S. App. 807), in which it found that the net liquidation value of all of appellants' covered rail properties as of April 1, 1976, was $42,509,299. The court established procedures for allocating this total amount among the seven appellants, and that matter was resolved without substantial objection. The court then turned to appellants' remaining contentions that (1) the amount of interest provided by the Rail Act was constitutionally inadequate, and (2) USRA's decision not to convey the Newark Bay Bridge under the Rail Act caused CNJ to suffer severance damages.

5. *Interest for the delay between conveyance and redemption of the certificates of value.* The 1976 amendments to the Rail Act, which created the certificates of value as a medium of payment, specified that the certificates would include interest at a rate of 8% per annum, compounded annually, from the date of conveyance to the date of redemption. § 306(c), 45 U.S.C. 746(c). As of June 30, 1984, interest under the statute totaled approximately $37.5 million (see J.S. 8 n.12). CNJ conceded that the statutory rate of interest was constitutionally "adequate" in 1976. Nevertheless CNJ claimed a constitutional right to additional compensation based upon unforeseen increases in interest rates that occurred after that time. See *Severance/Delay Damage Opinion*, 591 F. Supp. at 656 (J.S. App. 821).

The Special Court rejected appellants' claim and upheld the constitutionality of the interest provision in the Rail Act. First, the court concluded that the proper benchmark was the rate for " 'that type of marketable public debt security which constitutes a direct obligation of the United States Treasury having a duration approximat[ing] the period during which the deficiency was unpaid,' " which "is exactly what Congress" provided in connection with the certificates of value. *Severance/Delay Damage Opinion*, 591 F. Supp. at 657 (J.S. App. 824), quoting *United States* v. *Blankinship*, 543 F.2d 1272, 1276 (9th Cir. 1976). The court also pointed out the inherent difficulties of accepting appellants' contention

that the actual interest rates that occurred during the period should be used:

> [R]esort to *any* varying long-term bond yields to measure "delay compensation" is subject to a * * * fundamental criticism if, as here, such yields climb from period to period. This is that it would have been impossible for CNJ to shift from year to year from long term bonds with lower to higher rates as bond yields increased without incurring substantial capital losses.
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> * * * * *
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> [Conversely, a]ny computation on the basis of yields available on short-term Government obligations would have to take into account the transaction costs on frequent roll-overs.

Severance/Delay Damage Opinion, 591 F. Supp. at 659-660 n.7 (J.S. App. 827-828, 857 n.7) (emphasis in original). In addition, the court noted that the decisions primarily relied on by CNJ had allowed only simple interest rather than the compound interest provided in the Rail Act. *Id.* at 660 (J.S. App. 828-829).

Finally, the court reviewed "the unique circumstances of this case" and declined to "set aside the carefully considered determination of Congress, conceded by CNJ to have been reasonable at the time, that interest of 8% compounded annually constituted just compensation for the delay necessarily incident to the computation of the [value] of the railroads' properties." *Severance/Delay Damage Opinion*, 591 F. Supp. at 660 (J.S. App. 829). As the court explained (*id.* at 661 (J.S. App. 830)):

> [W]hen delay compensation is an integral part of a broad Congressional plan to preserve essential railroad service in the Northeast and to enable the bankrupt railroads in that region to receive billions of dollars from the Federal Treasury in compensation for properties whose operations were grinding to a halt, we are [not] bound to treat the decision of Congress as if it did not exist. The decision was rational not only in the sense that 8% compound interest on a government obligation with a maturity

> of eleven years and eight months was fair, as it concededly was, but in the broader sense that CNJ has adduced no evidence that anyone was then aware that interest rates would climb precipitously. Moreover, the decision clearly was a considered one. Congress did not adopt the time-honored 6% simple interest provision of the Declaration of Taking Act, 40 U.S.C. § 258a; instead it provided a much more generous 8% compound interest rate.

Furthermore, "[t]his is not the ordinary case where government, for a public purpose, deprives a citizen of property which he would have preferred to keep for his own use. Continued operation was the last thing the railroads wanted; it was something they had neither the desire nor the ability to perform. * * * Congress made numerous provisions in the Rail Act * * * granting financial aid to enable the railroads to keep alive between the date of enactment, January 2, 1974, and the date of conveyance, which turned out to be April 1, 1976." *Id.* at 662 (J.S. App. 831). Accordingly, while it recognized that the determination of just compensation is a judicial function (*id.* at 661 (J.S. App. 829-830)) and that a statutory rate of interest does not necessarily satisfy the constitutional standard in all instances (*id.* at 662 (J.S. App. 831)), the court sustained the provision for 8% interest "as part of * * * a comprehensive scheme * * * [in] a unique piece of legislation designed to cope with a national emergency of unparalleled magnitude." *Id.* at 663 (J.S. App. 832).

6. *Responsibility for the costs of removing the Newark Bay Bridge.* In 1972, the United States Coast Guard found that CNJ's Newark Bay Bridge, a structure some 1.4 miles long between Elizabethport and Bayonne, New Jersey, was an unreasonable obstruction to navigation. Rail service continued over the Bridge while the Coast Guard attempted to work out an arrangement with CNJ for the alteration or removal of the Bridge. *Severance/Delay Damage Opinion*, 591 F. Supp. at 665-668 (J.S. App. 836-841). In 1976, when the majority of appellants' properties were conveyed under the Rail Act, the Bridge was left with the CNJ estate (*id.* at 663-664 (J.S. App.

833)), but Conrail was granted an easement to use the Bridge for so long as passenger service continued across the Bridge. Conrail provided such service pursuant to a subsidy arrangement with the State of New Jersey until mid-1978, when the State terminated its subsidy; at that point the Conrail easement lapsed. *Id.* at 668 (J.S. App. 841). The Coast Guard then ordered that the Bridge be removed under Section 4 of the Bridge Act of 1906, 33 U.S.C. 494. *Severance/Delay Damage Opinion*, 591 F. Supp. at 668 (J.S. App. 842).[13] Because the Bridge was no longer being used in connection with rail service, CNJ was required to pay the cost of removal.[14]

The Special Court rejected CNJ's claim that the cost of removing the Bridge, estimated at $14 million, constituted severance damages for which compensation is required under the Fifth Amendment. It held that CNJ's claim "does not fall comfortably * * * within the traditional concept of severance damage" (*Severance/Delay Damage*

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[13] Section 4 of the Bridge Act of 1906 provides in pertinent part:

> No bridge erected or maintained under the provisions of [this Act] * * * shall at any time unreasonably obstruct the free navigation of the waters over which it is constructed, and * * * the Secretary of Transportation, after giving the parties interested reasonable opportunity to be heard, [may require the bridge owner] to so alter the [bridge] as to render navigation through or under it reasonably free, easy, and unobstructed * * *. [A]ll such obstructions shall be removed at the expense of the persons owning or operating [the] bridge.

In *Union Bridge Co.* v. *United States*, 204 U.S. 364 (1907), this Court held that enforcement of the duty of a bridge owner to pay to eliminate an unreasonable obstruction to navigation, pursuant to the Secretary of War's order under Section 18 of the Rivers and Harbors Appropriation Act of 1899 (33 U.S.C. 502), is not a taking within the meaning of the Fifth Amendment.

[14] In 1940, Congress enacted the Truman-Hobbs Act, 33 U.S.C. 511 *et seq.*, which apportions the cost of alteration or removal between the government and the bridge owner according to "the direct and special benefits which will accrue to the bridge owner as a result of the alteration." § 6, 33 U.S.C. 516. However, the Truman-Hobbs Act does not apply when a bridge has been taken out of rail operation. § 1, 33 U.S.C. 511.

Opinion, 591 F. Supp. at 669-670 (J.S. App. 844-845)) because the Rail Act conveyances were unrelated to CNJ's liability for the costs of removing the Bridge. Rather, it was the cessation of rail service on the Bridge that caused CNJ to incur those costs under the Bridge Act of 1906. The court noted that the conveyance of the adjacent tracks did not prevent the use of the Bridge for rail service, and indeed service continued over the Bridge for more than two years pursuant to a subsidy arrangement with the State of New Jersey. *Id.* at 669 (J.S. App. 844). Moreover, "[t]he Bridge had long ceased to have value for rail use" (*ibid.*), and "CNJ was unable to continue operation over the Bridge without state subsidy." *Id.* at 670 (J.S. App. 845). Thus, CNJ was required to bear the costs of removal because of economic circumstances and the State's termination of its subsidy, not because of the conveyance under the Rail Act.

After extensively reviewing the evidence, the Special Court also rejected the factual arguments advanced by CNJ to demonstrate that it would have avoided the removal costs in the absence of the Rail Act. First, the court stated that CNJ's failure to reach an agreement on removing the Bridge at a time when the government would have shared in the costs did not give rise to compensation because it did not result "from any taking or failure to take under the Rail Act" (*Severance/Delay Damage Opinion*, 591 F. Supp. at 670 (J.S. App. 845)) and because in any event the "responsibility for delay rests rather more in CNJ than in the Coast Guard. * * * [W]hether through necessity, obstinancy, or as a bargaining tactic, CNJ refused to accept responsibility for any part of the cost and even insisted on being paid millions of dollars for abandoning a patently worthless property." *Ibid.* (J.S. App. 845-846). Second, the court found that CNJ had "not established * * * on the facts" (*ibid.* (J.S. App. 846)) that absent the Rail Act the Port Authority of New York and New Jersey would have purchased the Bridge and paid the removal costs, and thus it was "altogether too speculative" (*id.* at 672 (J.S. App.

849)) to allow CNJ to recover on that basis. Third, although concluding that the State of New Jersey would have preserved rail service over CNJ's lines in the absence of the Rail Act, the court found that the State "'would not have had any interest in, and would not have bought the Newark Bay Bridge'" (*ibid.* (J.S. App. 850) (citation omitted)); in the alternative, the court further determined that, even if the State had bought the Bridge as part of an acquisition of the other CNJ properties, the overall purchase price would have been reduced to reflect "the benefit [the State] was thereby conferring by relieving CNJ of the burden of removing the Bridge at its own expense—a burden which CNJ would otherwise have been unable to unload." *Id.* at 673 (J.S. App. 851).

For these reasons, the Special Court concluded that the Bridge problem, which had "been with CNJ for years," did not represent a "sufficient basis, as a matter of fairness, let alone as a matter of constitutional requirement, for shifting to the United States the cost of removing a hindrance to navigation which was on the brink of becoming useless for rail service when the discussions leading to enactment of the Rail Act began." *Severance/Delay Damage Opinion*, 591 F. Supp. at 675 (J.S. App. 854).

ARGUMENT

The Special Court, based on its intimate familiarity with the extensive and complex proceedings below, correctly disposed of appellants' arguments in a series of thorough opinions upon which we rely. Although the court accepted many of appellants' legal contentions, it rejected their claims for additional compensation largely on the basis of the factual record. Moreover, most of the issues appellants raise are confined to the specific situation presented in this case.

In addition, as the only parties that have not settled their Rail Act claims (see page 2, *supra*), appellants stand alone in being affected by the judgment below. Under established principles, a summary affirmance is "an affirmance of the judgment only * * * and * * * leave[s]

undisturbed the judgment appealed from," but it does not adopt " 'the reasoning by which [the judgment] was reached' * * * [and] should not be understood as breaking new ground." *Mandel* v. *Bradley*, 432 U.S. 173, 176 (1977) (citation omitted); see also, *e.g.*, *Illinois Elections Bd.* v. *Socialist Workers Party*, 440 U.S. 173, 182-183 (1979). Accordingly, summary affirmance of the Special Court's judgment would have no broader consequence than to reject appellants' individual claims for a larger award.

In these circumstances, we submit that the Court should summarily affirm the judgment below and thereby bring to a conclusion this unique and nearly decade-old litigation.[15]

1. Appellants do not dispute the settled principle that just compensation generally means fair market value. See, *e.g.*, *Kirby Forest Industries, Inc.* v. *United States*, No. 82-1994 (May 21, 1984), slip op. 8; *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U.S. 470, 474 (1973); *United States* v. *Miller*, 317 U.S. 369, 374 (1943). The Special Court correctly applied this standard, under the Constitution and the Rail Act, to the complicated facts of this case and determined the market

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[15] Section 303(d) of the Rail Act (45 U.S.C. 743(d)) provides that a "finding or determination" of the Special Court under Sections 303(c) or 306 (45 U.S.C. 743(c), 746) "may be appealed directly to the Supreme Court of the United States in the same manner that an injunction order may be appealed under section 1253 of title 28." In addition, apparently because appeals are authorized from interlocutory as well as final decisions, Section 303(d) further provides that "[t]he Supreme Court shall dismiss any such appeal within 7 days after the entry of such an appeal if it determines that such an appeal would not be in the interest of an expeditious conclusion of the proceedings." The government did not contend that this appeal should be dismissed under the seven-day provision, and by order dated August 2, 1984, the Court directed that the appeal not be dismissed at the outset. That order, however, does not pre-determine the substantiality of the appeal or render it inappropriate for the Court summarily to affirm the judgment below in accordance with its customary practice under direct appeal statutes.

value of appellants' properties in the absence of the Rail Act.[16] Simply put, appellants, having opposed enactment of the Rail Act (see J.S. 18), now complain that they are dissatisfied with the fair market value found by the Special Court and believe that they are owed a larger award as a matter of fundamental fairness (*ibid.*).

The Special Court determined fair market value on the basis of what a buyer would have paid at the time for the conveyed properties; as the court summarized, transferors "are entitled to compensation for the properties conveyed by them * * * for whatever they could have realized for them in the absence of the Rail Act." *Rail Use Opinion*, 531 F. Supp. at 1210 (J.S. App. 293). In this case, the only potential buyer was the State of New Jersey. Moreover, under established principles, the price that the State would have been willing to pay would have been set by appellants' next best alternative use for the property—here, in the absence of any other purchasers, the liquidation or scrapping of the lines.[17] Thus, the

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[16] As described above (see page 5 & note 8, *supra*), the Special Court recognized that a different standard might apply if fair market value yielded a manifestly unfair result. It found, however, that the market value of $42.5 million for appellants' conveyed properties was not unfair, and appellants have made no showing to the contrary. The cases cited by appellants (J.S. 22 n.28), which apply the principle of manifest unfairness, do not hold that market value based upon liquidation is necessarily inadequate under the Constitution. The Special Court considered and correctly rejected the relevance of those decisions to the instant case. See *CMV Opinion*, 445 F. Supp. at 1017-1027 (J.S. App. 203-222).

[17] CNJ never seriously contended that its properties had a market value based on earnings power or that a private party would have purchased them in the absence of the Rail Act. See *Rail Use Opinion*, 531 F. Supp. at 1209, 1374-1375, 1380 (J.S. App. 291, 570-571, 579-580). Its belated assertion that it was "a rail system committed to remaining in business with alternatives it wished to pursue" (J.S. 20 n.27) incorrectly focuses on its subjective intentions rather than on objective market considerations, and in any event it rings hollow in light of the government's early concession that the standard of fair market value included all transferors' "right to use their properties for a profit." *CMV Opinion*, 445

Special Court correctly determined fair market value by reference to the amount "that could be obtained by sale for the next most valuable use, namely, a break-up of the railroad and a sale of its component parts." *CNJ Opinion*, 571 F. Supp. at 1279 (J.S. App. 680); see also, *e.g.*, *Rail Use Opinion*, 531 F. Supp. at 1215, 1324, 1325 (J.S. App. 300, 488, 489-490); *Severance/Delay Damage Opinion*, 591 F. Supp. at 673 (J.S. App. 851).[18]

F. Supp. at 1011 (J.S. App. 190). As the Special Court found, CNJ's only alternative to shutdown was a sale of its properties to the State of New Jersey at nonrail use values. See *Rail Use Opinion*, 531 F. Supp. at 1215, 1324, 1325, 1379, 1382 (J.S. App. 300, 488, 489-490, 578, 584); *CNJ Opinion*, 571 F. Supp. at 1279 (J.S. App. 680); *Severance/Delay Damage Opinion*, 591 F. Supp. at 673 (J.S. App. 851).

Moreover, the Special Court found that " 'the financial constraints on public bodies would have reinforced their determination to pay no more than the minimum for any lines.' " *Rail Use Opinion*, 531 F. Supp. at 1320 (J.S. App. 481) (citation omitted). As the court explained (*id.* at 1334-1335 (J.S. App. 505)):

> The * * * desire [by the State to keep the purchase price to a minimum] would have been particularly acute given the large amounts at stake, the financial difficulties facing state governments at that time, and the publicity that would have accompanied any such transaction. * * * [And] the public bodies would have had a strong upper hand * * * result[ing in] successful negotiations * * *.

[18] There is no basis for appellants' sweeping and novel assertion (J.S. 19) that "the scrap value of an operating rail system taken for continued rail use can never provide just compensation." Indeed, in *Chicago & Northwestern Transp. Co.* v. *United States*, 678 F.2d 665 (7th Cir. 1982), the court of appeals expressly agreed with the Special Court that "salvage value" satisfied the constitutional requirement of just compensation for an unprofitable rail line. Rejecting the position asserted by appellants here, the Seventh Circuit stated that "we think it irrelevant whether private property is taken for a new use or to continue an old one, and even question whether this is a meaningful distinction" (*id.* at 669). Compare J.S. 22.

Furthermore, appellants' reliance (J.S. 19-20) on *Denver* v. *Denver Union Water Co.*, 246 U.S. 178 (1918), is misplaced. That case involved the determination of rates for water service to the City of Denver. The City argued that the water company engaged

Appellants' main complaint (J.S. 23) is that the Special Court should have been bound by the value of the conveyed properties that was shown in various studies prepared or considered in connection with negotiations between CNJ and the State. However, the court extensively reviewed the negotiations and the studies and concluded from the record that the State would not have purchased the properties on that basis. See *Rail Use Opinion*, 531 F. Supp. at 1375-1378 (J.S. App. 571-577); *CNJ Opinion*, 571 F. Supp. at 1279-1284 (J.S. App. 681-690). As the court summarized the evidence of the negotiations (531 F. Supp. at 1377-1378 (J.S. App. 576-577)):

> [No] one * * * in State government was ready to make any final decision on the matter. Although [Commissioner of Transportation] Sagner apparently

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in business "merely at sufferance" and that, because the City could terminate the company and build its own water system, the company should be valued at "'junk value'" in setting rates (*id.* at 184). The Court rejected this argument, finding that the company held a franchise from the City and thus "that in considering the effect of the provisions limiting rates the plant must be valued not as 'junk' but as property useful and in use in the public service" (*id.* at 186). As the court explained in the passage cited by appellants (*id.* at 190-191):

> In this situation, there can be no question of the company's right to adequate compensation for the use of its property employed, and necessarily employed, in the public service; nor can it be doubted that the property must be valued as property in use. It involves a practical contradiction of terms to say that property useful and actually used in a public service is not to be estimated as having the value of property in use, but is to be reckoned with on the basis of its "junk value."

Here, in contrast to the situation in *Denver Union Water Co.*, appellants would not have been able to continue to provide rail service in the absence of the Rail Act. The question in this case is not a fair rate of return for services provided, as in *Denver Union Water Co.*, but rather just compensation for a transfer of property that had no capacity to generate earnings. In answering that question, the Special Court correctly determined the market value of the conveyed properties on the basis of what appellants could have realized by selling those properties for their most valuable alternative use—a sale at nonrail use values.

> had Governor Byrne's authority to "explore" the possibility of a purchase, there is no suggestion that he was ever authorized to close a deal, or even to make a tentative proposal. Nor is there any evidence that Sagner or his staff had drawn up any particular plans for acquisition or operation of the railroad. * * * Sagner never presented any definite proposal to buy CNJ to the Governor * * * or any of the * * * [federal or state] agencies that one would expect to participate in such a decision. Moreover, there was no consensus, either within Sagner's department or between Sagner and the various CNJ parties, as to an appropriate price.
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> The existence of substantial uncertainty as to the sale price and properties to be included in the transaction casts further doubt on CNJ's claim that an agreement had nearly been reached. * * *
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> In short, although the record suggests that Sagner pursued and probably favored a State purchase, it does not bear out the allegation that New Jersey was on the verge of buying CNJ's entire system. On the contrary, we cannot conclude with any confidence that any State purchase would have occurred at all. There are simply too many unknowns, too many decisions not yet made, too many important actors still absent from the stage, to permit that.

Appellants' reiteration of its view of the case does not undermine the Special Court's findings, which are amply supported in the record, or indicate any reason for this Court to revisit such fact-bound questions.[19]

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[19] Contrary to appellants' assertion (see J.S. 11, 14, 23-24), the Special Court was fully cognizant of and allowed for the difficulties of proof involved in determining fair market value. See *CMV Opinion*, 445 F. Supp. at 1029, 1030, 1045 (J.S. App. 226, 227, 258); *Rail Use Opinion*, 531 F. Supp. at 1214-1215 (J.S. App. 300).

Appellants' equivocal reliance (J.S. 25) on *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U.S. 470 (1973), is misplaced. *Almota* recognizes that the condemnation itself must not affect the just compensation that is due for the property taken and that the possibility of continued use of the property (absent the condemnation) should be considered in determining its value. The Special Court observed these principles by valuing CNJ's line in light of

Finally, the specific elements in the Special Court's nonrail use value findings about which CNJ complains—deductions for dismantlement, selling costs, and defective title, taking account of the effect of additional supply in the market, and discounting future proceeds to present value—are simply necessary aspects of determining realizable market values. These elements are found in many of the scrap value studies that are, as CNJ admits, "not an uncommon exercise in the railroad business" (J.S. 21). Indeed, each of these aspects was involved in the studies of liquidation value made in the *New Haven Inclusion Cases*, 399 U.S. 392, 436 (1970), where, as here, "asset value rather than earning power was the primary determinant because New Haven had 'long been dry of earning power'" (citation omitted).[20]

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the market conditions that would have existed in the absence of the Rail Act, including the abandonment and dismantlement of other rail lines that would not have been continued in rail use. In particular, the Special Court rejected CNJ's factual argument, which was the predicate for most of its legal contentions, that it would have been the first transferor to seek abandonment in the absence of the Rail Act and therefore it was entitled to preferential treatment in valuing its assets. See *Rail Use Opinion*, 531 F. Supp. at 1379-1381 (J.S. App. 579-581).

[20] Appellants' charge that the Special Court decided the case on the basis of "a preconceived view" (J.S. 26) ignores the obvious care that the court devoted to the issues and the substantial grounds —both legal and factual—that support its disposition. In addition, CJI itself presented the following table to the court overseeing its reorganization to show that, by litigating rather than settling this case, it fared better than transferors that settled (as measured in terms of the ratio between the amount of the recovery and USRA's original calculation of net liquidation value (NLV) in the final system plan (FSP)):

Transferor Estate	Date of Settlement	NLV as Settled	FSP Valuation	Percentage of FSP
Penn Central	12/4/80	$1,460,674,040	$494,967,000	295%
Reading	9/2/81	87,582,602	32,054,000	273%
Erie Lackawanna	12/25/82	229,007,090	60,297,000	379%

[Continued]

2. Appellants do not seriously dispute that the statutory certificates of value, redeemable in cash on or before a date certain and backed by the full faith and credit of the United States, could constitutionally be used as the medium of value.[21] See *CMV Opinion*, 445 F. Supp. at 999-1004 (J.S. App. 168-176), citing, *e.g.*, *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 155 (1974).[22] Rather, they argue (J.S. 15, 27) that the statutory interest rate of 8% per annum, compounded annually—although conceded to have been fully adequate at the time of the conveyances (see *Severance/Delay Damage Opinion*, 591 F. Supp. at 656 (J.S. App. 821))—in fact failed to keep pace with actual inflation and therefore is insuffi-

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[20] [Continued]

Transferor Estate	Date of Settlement	NLV as Settled	FSP Valuation	Percentage of FSP
Lehigh Valley	4/30/82	46,986,061	19,366,000	242%
Unsettled claims of CNJ and its affiliated companies		42,509,299	9,222,476	461%

See CJI Petition for Supplemental Proceedings, at 19, *In re Central R.R. of N.J.*, Civ. No. B401-67 (Bankr. D.N.J. June 25, 1984).

[21] It is well settled that "the Fifth Amendment does not forbid the Government to take [property] and pay for it later." *Kirby Forest Industries, Inc.* v. *United States*, No. 82-1994 (May 21, 1984), slip op. 8-9; see also *id.* at 2-3. The use of certificates of value under the Rail Act simply has the effect of postponing the date of payment of just compensation until after the conveyance has occurred. Provided that the rate of interest on the deferred payment is adequate (which is discussed below), there can be no substantial constitutional question about Congress's decision to employ certificates of value as the medium of compensation.

[22] Appellants also do not controvert the Special Court's finding that the specified date of December 31, 1987, as the outside time for redemption, was a reasonable estimate of the period necessary to resolve the issues of just compensation. *Severance/Delay Damage Opinion*, 591 F. Supp. at 660-661 n.8 (J.S. App. 857-858 n.8).

cient to provide just compensation.[23] Appellants' challenge to the constitutionality of the Act of Congress is unavailing and does not call for plenary review in this case.

It is common ground that interest is constitutionally required in view of the delay between the date of conveyance under the Rail Act and the date of redemption of the certificates of value. As the Court has recently stated, "if disbursement of [a condemnation] award is delayed, the owner is entitled to interest thereon sufficient to ensure that he is placed in as good a position pecuniarily as he would have occupied if the payment had coincided with the appropriation." *Kirby Forest Industries, Inc.* v. *United States*, slip op. 9. Interest is designed to "produce the full equivalent of * * * value paid contemporaneously with the taking." *Seaboard Air Line Ry.* v. *United States*, 261 U.S. 299, 306 (1923).

The rate of interest provided in the Rail Act satisfies this constitutional standard. By definition, a reasonably prudent investor would have been indifferent between the payment of compensation on the date of conveyance and a deferred payment by the government that accrued interest at the prevailing rate of 8% per year; that is the very meaning of appellants' concession and the Special Court's finding that 8% compound interest was reasonable in 1976 because it reflected the return existing as of the conveyance date for government securities of an appropriate maturity. See *Severance/Delay Damage Opinion*, 591 F. Supp. at 656 (J.S. App. 821). In economic terms, an immediate condemnation award by the government and a delayed award earning the then-market rate of 8% interest are fully equivalent. Cf. *Jones & Laughlin Steel Corp.* v. *Pfeifer*, No. 82-131 (June 15, 1983), slip op. 16, 18. Accordingly, the Rail Act provides compensation, including interest, that has the same economic value as a transferor would have received if payment had been made on the date of the conveyance. Appellants are in the

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[23] By June 30, 1984, approximately $37.5 million in interest had accrued under the statute (see J.S. 8 n.12).

same position they would have been in if they had been paid in cash for the conveyed properties in April 1976 and had invested the award in government bonds that matured in 1987.[24]

To be sure, the actual rate of inflation that might occur subsequent to the conveyance could have been—and, in this case, in fact was—higher than was anticipated at the time. But the possibility or "risk" of higher inflation was already built into the market figure for government securities; if that were not true, investors would have been unwilling to purchase government securities at the market rate insofar as that rate was believed to underestimate the prospect of future inflation, and thus the market rate would have increased to come into line with projected inflation. Cf. *Jones & Laughlin Steel Corp.* v. *Pfeifer*, slip op. 15. By providing interest at the appropriate market rate, therefore, the Rail Act offered transferors the full economic equivalent of the immediate payment of just compensation.

Moreover, as the Special Court noted (*Severance/Delay Damage Opinion*, 591 F. Supp. at 663 (J.S. App. 832)), appellants "would hardly have agreed" to give back a portion of their award if inflation had turned out to be lower than expected and consequently 8% interest proved unduly generous. However, the Just Compensation Clause is not, as appellants argue, a one-way street; just compensation must be " 'just' both to an owner whose property is taken and to the public that must pay the bill." *United States* v. *Commodities Trading Corp.*, 339 U.S. 121, 123 (1950). In effect, appellants seek to require the government to insure them against the effects of unexpected changes in interest rates; but the Constitution does

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[24] Appellants recognize (J.S. 27) that it is "well settled that the rates of return on investments in conservative debt instruments available in the marketplace during the period of delay is an appropriate measure of the delay damages." See also *Jones & Laughlin Steel Corp.* v. *Pfeifer*, slip op. 13-14 (discount rate "should be based on the rate of interest that would be earned on 'the best and safest investments' " and "should not reflect the market's premium for investors who are willing to accept some risk of default").

not, in the guise of just compensation, entitle them to be held harmless from such possibilities. Contrary to established principles, the result advocated by appellants would put them, not in the same position, but in a better position, than if they had received their compensation award contemporaneously with the conveyance of their property. See *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U.S. at 478.

Nor is it clear that appellants in fact would have obtained more than 8% interest if they had been paid their compensation award in April 1976 and invested the proceeds on their own. As the Special Court observed, if appellants had made long-term investments, "it would have been impossible for [them] to shift from year to year from long term bonds with lower to higher rates as bond yields increased without incurring substantial capital losses." *Severance/Delay Damage Opinion*, 591 F. Supp. at 659 (J.S. App. 827-828). On the other hand, short-term investments would have resulted in substantial "transaction costs on frequent rollovers" (*id.* at 660 n.7 (J.S. App. 857 n.7)) and exposed appellants to the risk that interest rates would decline rather than increase at any given point. Viewed from the perspective of the conveyance date in April 1976—which is the relevant perspective for condemnation purposes—it was equally likely that any investment strategy would do worse instead of better than the 8% interest provided in the Rail Act. The fair market equivalent of cash in April 1976 was the rate of interest on a risk-free government bond with an appropriate maturity date—and that is precisely what appellants were given.

Appellants rely on decisions holding rates of interest provided in other statutes to be insufficient. We do not generally dispute either the result in those cases or the proposition, as the Special Court recognized (*Severance/Delay Damage Opinion*, 591 F. Supp. at 661 (J.S. App. 829-830)), that the determination of a constitutionally adequate interest rate is ultimately a judicial function; indeed, the United States has acquiesced in a number of these decisions. See *Kirby Forest Industries, Inc.* v.

United States, slip op. 9 n.16. But that line of authority does not compel the outcome that appellants seek here.

First, the decisions upon which appellants principally rely involved the award of simple interest rather than compound interest as provided in the Rail Act. Although appellants attempt to invoke the portion of the rulings that sets aside the statutory interest rate, they distort the decisions by claiming "an element which * * * [those courts] ha[ve] declined to add, namely, compound rather than simple interest." *Severance/Delay Damage Opinion*, 591 F. Supp. at 660 (J.S. App. 828). As the Special Court correctly understood (*id.* at 659-660 (J.S. App. 828-829)), appellants cannot have it both ways.

Moreover, the government demonstrated below, which showing "was not disputed by CNJ," that the simple interest approach in these decisions "would not produce delay compensation for [them] significantly higher than the 8% compound interest provided for in [the Rail Act]." *Severance/Delay Damage Opinion*, 591 F. Supp. at 659-660 (J.S. App. 828). For example, as of December 31, 1983, the simple interest methodology yields an amount of interest that is only .0274 larger than that produced by the statutory rate[25] (see Reply of the Government Parties in Support of the Proposed Final Judgment Upon the Claims of the Central Railroad Company of New Jersey, App. 1, at 1 (Jan. 19, 1984))—an amount that appellants acknowledged below was "not much more" than that provided under the Act. See Answer and Memorandum of Central Jersey Industries, Inc., in Support of Objections to Final Judgment at 28 (Jan. 5, 1984). Similarly, if the redemption date of the certificates of value is taken to be December 31, 1987 (the outside date specified in the Rail Act), the amount of interest under the simple interest approach would equal the interest under the statute only if the applicable rate of interest during the en-

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[25] That is, the difference between the amount of interest under the simple interest and the statutory approaches, divided by the statutory interest amount, equals .0274.

tire period January 1, 1984-December 31, 1987 was approximately 16%—a rate substantially in excess of anything ever allowed in any of the decisions that have followed the simple interest approach. See Reply of the Government Parties in Support of the Proposed Final Judgment, *supra*, at 27 & App. 1, at 1. Thus, none of these decisions supports an award of interest that would be substantially different from that provided by the Rail Act or compels the conclusion that the statutory interest provision is constitutionally unreasonable.[26]

In upholding the validity of the 8% compound interest rate in the Rail Act, the Special Court also correctly emphasized "the unique circumstances of this case." *Severance/Delay Damage Opinion*, 591 F. Supp. at 660 (J.S. App. 829). Congress's decision to establish this interest rate "clearly was a considered one," and it "provided a much more generous 8% compound interest rate" instead of "the time-honored 6% simple interest provision." *Id.* at 661 (J.S. App. 830). And, as appellants conceded and the Special Court found (*id.* at 656, 661, 663 (J.S. App. 821, 830, 832)), this figure was fully reasonable at the time it was adopted and no evidence was adduced to show that anyone then anticipated the subsequent rise in interest rates. Furthermore, the statutory interest provision was "an integral part of a broad Congressional plan to preserve essential railroad service in the Northeast and to enable the bankrupt railroads in that region to receive billions of dollars from the Federal Treasury in compensation for properties whose operations

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[26] Appellants also cite (J.S. 28), without further argument, two decisions that have awarded compound interest. However, as the Special Court explained, "[t]he most that CNJ can extract from [those decisions] is that compounding of interest is not improper *when the interest yield has been computed on an appropriate basis.* * * * [T]his would be either the yield on government bonds purchased at the time of the taking and maturing at the date of payment * * * or yields on short-term government obligations." *Severance/Delay Damage Opinion*, 591 F. Supp. at 660 (J.S. App. 829) (emphasis in original). The Rail Act affords appellants the first of these constitutionally permissible alternatives. *Ibid.*

were grinding to a halt." *Id.* at 661 (J.S. App. 830). Thus, "[t]his is not the ordinary case where government * * * deprives a citizen of property which he would have preferred to keep for his own use. Continued operation was the last thing the railroads wanted; they had neither the desire nor the ability to perform." *Id.* at 662 (J.S. App. 831). Especially when viewed in the context of a bail-out for distressed railroads "to cope with a national emergency of unparalleled magnitude" (*id.* at 663 (J.S. App. 832)), the interest provision in the Rail Act is not unconstitutional.

3. Finally, appellants contend (J.S. 30-32) that the costs of removing CNJ's Newark Bay Bridge constitute severance damages that are compensable under the Rail Act. The Special Court correctly rejected this claim, holding that CNJ's removal costs were not the result of the Rail Act.

The right to erect a bridge across a navigable waterway is "subject to the paramount right of navigation." *Union Bridge Co.* v. *United States*, 204 U.S. 364, 398 (1907). Under Section 4 of the Bridge Act of 1906 (33 U.S.C. 494), the Secretary of Transportation may order the alteration or removal of a bridge that becomes an obstruction to navigation "at the expense of the persons owning or operating [it]." However, in the Truman-Hobbs Act of 1940 (33 U.S.C. 511 *et seq.*), Congress provided that, with respect to bridges over navigable waters that are in use and operation for the purpose of carrying railroad traffic, the United States would pay the principal share of the cost of alteration or removal and the owner would pay only that portion equal to any benefit it accrued. Therefore, unless a bridge is engaged in rail carriage, the bridge owner is "not entitled to any compensation for the alteration or removal of the bridge as a result of navigation needs." *Southern Ry.* v. *TVA*, 294 F.2d 491, 493 (5th Cir. 1961). See *United States* v. *New York C. R.R.*, 252 F. Supp. 508 (D. Mass. 1965), aff'd, 358 F.2d 747

(1st Cir. 1966) (bridge owner was liable for removal costs after the rail line across the bridge was abandoned, notwithstanding the existence of prior plans to alter the bridge under the Truman-Hobbs Act).

Appellants do not contest these legal principles. They also do not contest that the Newark Bay Bridge had been declared an obstruction to navigation and was required to be dismantled when rail service pursuant to the State's subsidy was terminated in 1978. See *Severance/Delay Damage Opinion*, 591 F. Supp. at 668 (J.S. App. 841-842). Nor do they contest that "[t]he Bridge had long ceased to have value for rail use." *Id.* at 669 (J.S. App. 844). Thus, the conveyance of other properties under the Rail Act, which left the Bridge available for rail service as long as the State continued its subsidy, did not cause CNJ to become responsible for the cost of removal. As the Special Court summarized (*id.* at 675 (J.S. App. 854)), "the Bridge problem has been with CNJ for years and we see no sufficient basis, as a matter of fairness, let alone as a matter of constitutional requirement, for shifting to the United States the cost of removing a hindrance to navigation which was on the brink of becoming useless for rail service when the discussions leading to enactment of the Rail Act began."

Appellants contend, however, that absent the Rail Act CNJ could have managed to avoid the cost of removal. This contention is incorrect. First, the Special Court found, based on record evidence, that the Port Authority of New York and New Jersey had not in fact agreed to purchase the Bridge, and there is no basis to conclude that such a purchase would ever have taken place. See *Severance/Delay Damage Opinion*, 591 F. Supp. at 670-672 (J.S. App. 846-849). Second, the court also found that the State of New Jersey would not have purchased the Bridge as necessary to preserve rail service in the absence of the Rail Act (*id.* at 672-673 (J.S. App. 849-851)), and, alternatively, that any purchase of the Bridge in connection with the State's acquisition of appellants' other properties would have included a reduction in the

price to reflect "the benefit [the State] was thereby conferring by relieving CNJ of the burden of removing the Bridge at its own expense—a burden which CNJ would otherwise have been unable to unload. * * * [T]he Bridge was a $14 million albatross." *Id.* at 673-674 (J.S. App. 851-852).[27] The factual record supports the finding that CNJ would not have been spared the cost of removing the Bridge but for the Rail Act, and further review of this issue is plainly unwarranted.

CONCLUSION

The judgment of the Special Court should be affirmed.

Respectfully submitted.

REX E. LEE
Solicitor General

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General Counsel—Litigation
United States Railway Association

NOVEMBER 1984

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[27] The Special Court additionally noted that CNJ—"whether through necessity, obstinacy, or as a bargaining tactic"—had rejected proposals to remove the Bridge while it was still in rail service and thus subject to the Truman-Hobbs Act. See *Severance/Delay Damage Opinion*, 591 F. Supp. at 670 (J.S. App. 846). As the court stated (*ibid.* (J.S. App. 845)), "responsibility for delay rests rather more in CNJ than in the Coast Guard" and at all events "any injury [CNJ suffered] from the Coast Guard's delay * * * was not from any taking or failure to take under the Rail Act" and hence is not compensable here.

APPENDIX

1. Transferors of rail properties under the Regional Rail Reorganization Act of 1973, as amended, 45 U.S.C. 701 *et seq.*, that settled their claims in the Special Court proceedings

Erie & Kalamazoo Railroad Company—Settlement Agreement approved March 21, 1980

Penn Central Company (formerly Penn Central Transportation Co.), and the following affiliated transferors—Settlement Agreement approved December 5, 1980

American Contract Company
Baltimore and Eastern Railroad Company
Beech Creek Railroad Company
Central Indiana Railway Company
Chicago River and Indiana Railway Company
Chicago, Kalamazoo and Saginaw Railway Company
Cleveland and Pittsburgh Railroad Company
Cleveland, Cincinnati, Chicago & St. Louis Railway Co.
Connecting Railway Company
Delaware Railroad Company
Despatch Shops, Inc.
Detroit Manufacturers' Railroad
Erie and Pittsburgh Railroad Company
Fort Wayne and Jackson Railroad Company
Hudson River Bridge Company at Albany
Indianapolis Union Railway Company
Joliet and Northern Indiana Railroad Company
Little Miami Railroad Company
Mahoning and Shenango Valley Company
Mahoning Coal Railroad Company
Manor Real Estate Company
Michigan Central Railroad Company
New York Central Railroad Development Corporation
New York Connecting Railroad Company
Northern Central Railway Company
Penndel Company

Penndiana Improvement Corporation
Pennsylvania and Atlantic Railroad Company
Pennsylvania Tunnel and Terminal Railroad Company
Peoria and Eastern Railway Company
Philadelphia and Trenton Rail Road Company
Philadelphia, Baltimore and Washington Railroad Company
Pittsburgh, Fort Wayne and Chicago Railway Company
Pittsburgh, Youngstown & Ashtabula Railway Company
Providence Produce Warehouse Company
Shamokin Valley and Pottsville Railroad Company
South Manchester Railroad Company
Union Depot Company (at Columbus, Ohio)
Union Railroad Company of Baltimore
United New Jersey Railroad and Canal Company
Waynesburg & Washington Railroad Company
Waynesburg Southern Railroad Company
West Jersey and Seashore Railroad Company

Pennsylvania-Reading Seashore Lines—Settlement Agreement approved January 26, 1981

Dayton Union Railway Company—Settlement Agreement approved February 12, 1981

Lehigh & Hudson River Railway Company—Settlement Agreement approved February 26, 1981

New York & Long Branch Railroad Company—Settlement Agreement approved February 26, 1981

Reading Company and the following affiliated transferors—Settlement Agreement approved September 2, 1981

East Pennsylvania Railroad Company
Eastern Real Estate Company
Port Reading Railroad Company
Trenton-Princeton Traction Company
Wilmington and Northern Railroad Company

Delaware & Bound Brook Railroad Company—Settlement Agreement approved October 21, 1981

Philadelphia, Germantown & Norristown Railroad and its former affiliate Plymouth Railroad Company—Settlement Agreement approved October 23, 1981

North Brookfield Railroad Company—Settlement Agreement approved January 22, 1982

North Pennsylvania Railroad Company—Settlement Agreement approved January 25, 1982

Erie Lackawanna Railway Company and the following affiliated transferors—Settlement Agreement approved January 25, 1982

Erie Land and Improvement Company
Erie Land and Improvement Company of Pennsylvania
Hoboken Ferry Company
Hudson Realty Company
Lackawanna & Wyoming Valley Railway Company
Lawroy Land Company
Rochester & Genesee Valley Railroad

Norwich & Worcester Railroad Company—Settlement Agreement approved April 19, 1982

Lehigh Valley Railroad Company and the following affiliated transferors—Settlement Agreement approved April 30, 1982

Consolidated Real Estate Company
United Real Estate Company

Ann Arbor Railroad Company—Settlement Agreement approved June 10, 1982

Niagara Junction Railway Company—Settlement Agreement approved July 7, 1982

Kalamazoo, Allegan & Grand Rapids Railroad—Settlement Agreement approved September 7, 1982

Ironton Railroad Company—Settlement Agreement approved September 24, 1982

Holyoke & Westfield Railroad Company—Settlement Agreement approved December 10, 1982

Allentown Terminal Railroad Company—Settlement Agreement approved May 27, 1983

Troy & Greenbush Railroad Association—Settlement Agreement approved July 6, 1983

Lehigh and New England Railroad Company—Settlement Agreement approved May 14, 1984

Note: The following two railroads were originally designated by the Special Court as parties to the proceedings below, under the assumption that they had transferred properties under the Rail Act. In fact, they transferred no properties and had no claims to be considered in the Special Court.

Buffalo Creek Railroad
Canton & Loudon Railway

2. Transferees of rail property under the Regional Rail Reorganization Act of 1973, as amended, in addition to Consolidated Rail Corporation

Baltimore & Ohio Railroad Company
Bessemer & Lake Erie Railroad Company
Black River & Western Corporation
Boston & Maine Corporation
Burlington Northern Inc.
Chesapeake & Ohio Railway Company
Chicago, Milwaukee, St. Paul & Pacific Railroad Company
Chicago & Northwestern Transportation Company
Delaware & Hudson Railway Company
Detroit & Mackinac Railway Company
Detroit, Toledo & Ironton Railroad Company
Grand Trunk Western Railroad Company
Illinois Department of Transportation

Illinois Terminal Railroad Company
Louisville & Nashville Railroad
Maryland & Pennsylvania Railroad Company
Massachusetts Bay Transportation Authority
Michigan Department of Highways & Transportation
New Hope & Ivyland Railroad
New Jersey Department of Transportation
Norfolk & Western Railway Company
Pennsylvania Department of Transportation
Pittsburgh & Lake Erie Railroad Company
Providence & Worcester Company
Southern Railway Company
Toledo Peoria & Western Railroad Company
Union Railroad Company

3. Parties granted intervention in the valuation proceedings

Institutional Investors Penn Central Group and certain Penn Central Indenture Trustees

The First National Bank of Chicago as Trustee under First Mortgage Indenture of the Chicago River and Indiana Railroad Company

Provident National Bank and A. Wakelee Swartz, Jr., as Indenture Trustees for Pennsylvania Tunnel and Terminal Railroad Company, and the Bank of New Jersey, as Indenture Trustee for New York Connecting Railroad Co.

Citibank, N.A., as Agent for the Committee of Secured Bank Creditors in the Penn Central Transportation Company Reorganization Proceedings

Richard Joyce Smith, Trustee of the Property of the New York, New Haven & Hartford R.R. Co.

Penn Central Company (owner of all of the stock of Penn Central Transportation Co., prior to reoganization of the latter)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN THE MATTER OF THE VALUATION PROCEEDINGS UNDER §§ 303(c) AND 306 OF THE REGIONAL RAIL REORGANIZATION ACT OF 1973

CENTRAL JERSEY INDUSTRIES, INC.
a corporation of the State of New Jersey, *et al.*,
Appellants,

v.

THE UNITED STATES RAILWAY ASSOCIATION AND THE UNITED STATES OF AMERICA, *et al.*,
Appellees.

ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

BRIEF OF APPELLANTS IN OPPOSITION TO MOTION TO AFFIRM

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November 26, 1984

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ON APPEALS FROM THE SPECIAL COURT, REGIONAL RAIL REORGANIZATION ACT

BRIEF OF APPELLANTS IN OPPOSITION TO MOTION TO AFFIRM

The Government Parties in their Motion to Affirm seek to foreclose appellants [1] (CNJ) from any serious appellate review of the judgment of the trial court below, stressing the limited precedential value of a summary affirmance.[2] It is not surprising that the Government takes this tact. This is the only case ever to have

1. The listing required by Rule 28.1 is included in our Jurisdictional Statement (J.S.) ii.

2. While not possessing the precedential value of an opinion of this Court after plenary hearing, summary affirmance would have precedential value beyond simply rejecting CNJ's claim for a larger award.

adopted junk value as a measure of the just compensation payable for operating facilities taken for continued use. It is the first case to have held that the Government may deliver its IOU as just compensation for the taking, even though the market value of the IOU when delivered was 15% less than the value found by the Court for the assets taken. It presents the only modern instance in which a court has determined that the intensity of the public need for the assets taken justifies adherence to a prospective legislative determination of delay compensation, despite the fact that it proved to be substantially below interest rates prevailing during the period of delay on all forms of conservative investments.

These are extraordinary rulings; but the Government cloaks their significance by oversimplifying the proceedings at the trial level and the issues arising therefrom. We respond below to the Government's presentation. Our principal contention, however, is that the Special Court has broken new and dangerous ground in the law of just compensation. Its conclusions are of great importance to the development of the law and to the thousands of unpaid creditors of the CNJ estate.[3] They deserve plenary appellate review; and Congress contemplated in § 303(d) of the Rail Act that such review would be by the Supreme Court.

1. *The Valuation Standard*—The Government presents a two-pronged approach to the issue of the valuation standard.

Mandel v. *Bradley*, 432 U.S. 173 (1977), relied upon by the Government and cases cited therein, only cautioned that summary affirmance is not to be viewed as "breaking new ground" in the sense of renouncing doctrines previously adopted by this Court after full argument. *Id.* at 176. However, the issues presented herein for the most part, if not entirely, have not yet been passed upon by this Court. *Illinois Elections Board* v. *Socialist Workers Party*, 440 U.S. 173 (1979), also cited by the Government, recognizes that summary affirmance does have precedential value, although less than a full opinion after plenary hearing. *Id.* at 180. See also *Metromedia, Inc.* v. *San Diego*, 453 U.S. 490, 499 (1981). In this case, the precedential weight of this Court's summary affirmance would probably be more than in most, considering the great eminence of the panel below.

3. CNJ is the only transferor estate that has been unable to pay its unrelated creditors in full.

First, it contends that the Special Court simply acted under traditional principles and found the fair market value of the assets. This is not so for the reasons set forth at pages 23 through 25 of the Jurisdictional Statement which the Government has not addressed. The Special Court rejected the market evidence as to how potential rail use purchasers valued the assets and what they were prepared to pay for them, finding that "the minds of all concerned in 1974 were attuned to a higher scale", *CNJ Opinion,*[4] 571 F. Supp. 1269 at 1284 (Regional Rail Reorg. Ct. 1983) (CA 689), than that considered appropriate by the Court; and it also declined to find the scrap value of the assets in the real world markets as they existed on April 1, 1976. The traditional fair market value tests would be based upon a factual inquiry into the existing market factors at the pertinent time as well as the methodologies employed and valuations reached by the distinguished appraisers (some of whom were to become Government experts in this case) who had studied the value of CNJ's rail assets in non-litigation contexts. However, the Special Court put all of this aside in favor of the creation of its own judicial scrap model which priced CNJ's transferred assets under forced sale conditions in markets hypothetically glutted by the assets of all other transferors, who were presumed to be involved in a simultaneous liquidation. No one has ever explained how such a model, which posits as its basic assumption a circumstance in which all transferors are scrambling to sell their properties at the same time, comports with the uncompelled willing buyer/willing seller concept which is at the heart of the fair market rule, *Kirby Forest Industries, Inc.* v. *U.S.*, ____ U.S. ____, 52 U.S.L.W. 4607, 4610 (U.S. May 21, 1984); and no one has ever explained how the CNJ could be a willing seller at a $42.5 million level when everyone involved was aware of the much higher results reflected in all the scrap value studies done by 1974, the time at which, the Court found, the sales price would have been agreed upon. *Rail Use Opinion,* 531 F. Supp. 1191 at 1311 (CA-466). The Special

4. We have continued to follow the convention used by the Court below and in our prior submission of referring to the opinions of the Special Court in this case by an abbreviated form of citation.

Court did not apply the traditional fair market value rule; for if it had, CNJ would not have raised a valuation issue on appeal.

The Government's second approach to the valuation issue is to contend that net scrap values are a proper constitutional measurement where the properties lack earning power, adding the gratuitous observation that CNJ was never serious in its contentions about earning power or the value of its properties to private parties.[5] However, the trials that were scheduled pursuant to the Second and the Sixth Pretrial Orders (CA-900) were directed at establishing what would have been received from hypothetical dispositions occurring in the absence of the Rail Act if all transferors sought to dispose of their properties at the same time and not at establishing the earning power *vel non* of the properties. Under those circumstances set by the Court, CNJ contended that the State of New Jersey would have been the purchaser of last resort of its rail assets and relied upon the evidence of its actual negotiations with the State and the studies that the State had done of the railroad to establish the price that would have been paid. We disagree with the Government's contention that scrap value is a proper constitutional measure where the property lacks earning power. (See J. S., 19-22). The only authority to support the Government's position on this issue is the Opinion of the Special Court below.[6] All of the other authorities, as well as the commentators, are of a contrary view. (J. S., 22). The issue is

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5. The gratuitous observation is not fair; for CNJ did submit evidence regarding the potential earning power of its properties as well as the interest of other private parties in them. The former was unrebutted and never evaluated by the Court. The latter, including the Chessie's negotiations for the lease of the CNJ, were taken note of by the Special Court. (See J.S., 5).

6. *Chicago & Northwestern Transportation Co.* v. *U.S.*, 678 F.2d 665 (7th Cir. 1982) does not support the Government position. The question in that case, described therein as one of "first impression under the 1980 Staggers Rail Act", involved the meaning of the term "fair market value" as applied to an abandoned rail line. 678 F.2d at 666. There was no taking but rather an effort by the railroad to obtain ICC approval of a price for an abandoned line greater than that which certain localities seeking to preserve commuter service were willing to pay. In upholding a price based on estimated "salvage value", identified as "fair market value" for nonrail use, the Court conceded that the result might be "harsh". *Id.* at 670. Whatever the merit of that holding, the rail

one of substantial importance which should be fully considered and resolved by this Court.

2. *The Form Of The Compensation And Delay Damages*—Contrary to the Government's assertion (Motion, 21), CNJ does dispute the constitutional sufficiency of the form of the compensation. CNJ contends that it is improper to deliver a Government debt obligation, instead of cash, as just compensation—particularly where the obligation is not payable until 3 ½ years after the entry of final judgment and where it accrues interest at a rate so low that the fair market value of the obligation when delivered is 15% less than its face value. The Government, contending that this is a settled question, cites the Special Court's *CMV Opinion*, 445 F. Supp. at 999 (Regional Rail Reorg. Ct. 1977) and this Court's Opinion in the *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 155 (1974). The issue involved there, however, was whether the Fifth Amendment requires payment in cash and not the sufficiency of a Government note of discounted value; and on the question of cash this Court specifically reserved decision. *Id.* at 151-52. Other courts have held, contrary to the Special Court, that cash was required. (See J. S., 26-27). As indicated earlier, this, as well as the specific form of payment used here, raise important questions of broad public significance which warrant full review by this Court.

As noted, the question of the proper amount of interest to which CNJ is entitled for the delay in payment for its properties is certainly one of broad public interest, affecting not only the ultimate recovery in this case but all federal and state takings in situations where payment has been delayed. The ruling below, in limiting interest for the entire period of the delay to that which could have been obtained on long-term Government bonds at the time of the taking, notwithstanding the great increases in interest rates during the extended period of delay, conflicts with rulings of other lower federal courts. More importantly, it contravenes a basic principle laid down many times by this Court that the former owner is entitled to interest in an amount sufficient to

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properties here had not been abandoned but rather taken by the Government for continued operation.

place him in as good a position monetarily as he would have been had the payment coincided with the appropriation. *Seaboard Air Line Ry.* v. *U. S.*, 261 U.S. 299, 306 (1923); *U. S.* v. *Miller*, 317 U.S. 369, 373 (1943): *Kirby Forest Industries, Inc.* v. *U.S.*, ____*U. S.* ____, 52 U.S.L.W. 4607, 4610 (U.S. May 21, 1984). In conformity with this principle, other federal lower courts have held that the former owner's interest entitlement must be measured by the rates prevailing on suitable investments between the date of taking and the date of payment, representing investment opportunities available had the former owner received payment at the time of the taking. See, *e.g.*, *Georgia Pacific Corp.* v. *U.S.*, 640 F.2d 328, 365 (Ct. Cl. 1980); *Miller* v. *U.S.*, 620 F.2d 812, 838-39 (Ct. Cl. 1980); *U. S.* v. *97.19 Acres*, 511 F. Supp. 565, 569 (D. Md. 1981). The thesis of the Special Court that the varying rates during the delay period could not be considered because of turnover costs is linked to its unwarranted assumption that investment in long-term Government securities was the former owner's sole or preferred option. Of course, the former owner had other options, including short-term investments of a year or less whose turnover costs, if any, would be minimal and offset many times over by the dramatic rise in interest rates. The proofs showed that CNJ had in fact pursued such a program once it emerged from reorganization, earning an average yield of approximately 13% from 1979 through 1983.

The Government now proffers a thesis that "the possibility or 'risk' of higher inflation was already built into the market figure for Government securities" (Motion, 23); for, otherwise, investors would not buy this long-term paper. We are not aware of any support for that proposition; and certainly *Jones & Laughlin Steel Corp.* v. *Pfeifer*, ____ *U.S.* ____, 51 U.S.L.W. 4795 (U.S. June 15, 1983), upon which the Government relies, is inapposite. It did not involve the question of compensation for past delay in payment, but rather the matter of discounting in advance an award for personal injuries to reflect the present value of a future stream of income. The estimates and projections required in the latter exercise are not involved here where the actual rates are in

fact available at the time of the delayed payment. That case, moreover, did not involve a question of just compensation under the Constitution.

Contrary to the Government's suggestion, CNJ is not urging a "one way street" - *i.e.*, saying that it could not have been awarded rates lower than 8% had there been a drop in interest rates during the delay period (Motion, 23). Had there been such a drop, we assume that the Special Court under Section 303(c) of the Rail Act would have exercised its responsibility to assure that the compensation awarded did not exceed "constitutional minimum" value and, if the investment picture warranted, reduced the interest allowed. For the same reason, the Special Court was required by Section 303(c) to allow interest at rates higher than the statutory rate which prevailed during the delay period.

Nor was the statutory provision for compounding its 8% rate a "generous" offering as the Special Court and now the Government state (Motion, 26), but rather simple recognition of compounding as a common feature of investment debt offerings. Indeed, the limitation to annual compounding is less generous than that generally available in debt securities' markets where semi-annual payment of interest is common, including interest payable on long-term Government debt. Accordingly, to deny compounding is to deny full compensation for the opportunities the former owner lost during the period of delay. Various lower federal courts which have awarded compounding have done so in recognition of this and not because, as the Special Court and the Government theorize (Motion, 25), the underlying interest rates may have been relatively low. The few courts which have rejected compounding have done so without any meaningful discussion of the question. (See J. S., 28). This Court has not yet passed upon the particular question.

3. *Severance Damages*—The Government poses the question of severance damages in the context of bridge removal costs "which were not caused by the Rail Act and would have been incurred in the absence of that Act." (Motion, (I)). Had this been the case, there would be nothing to review in this regard,

indeed, no controversy. However, uncontroverted facts show that this is not the context of the question.

As the Special Court found, rail service ceased on CNJ's Newark Bay Bridge when Conrail decided to discontinue such service. The decision to terminate service was made in the Final System Plan under the Rail Act when it was decided to exclude the CNJ bridge from the properties to be taken for continued rail service. An easement was retained for passenger service which, as the Government points out, was provided for a brief period after 1976 but discontinued in 1978. The Final System Plan contemplated rerouting all CNJ Newark Bay Bridge freight traffic over the Penn Central-Lehigh Valley Bridge to the north. The Special Court's ruling that the bridge was not put out of service as a result of the Rail Act and its implementation is, therefore, at variance with these uncontroverted facts. As noted in our Jurisdictional Statement (31), why the condemnor decided to render the bridge useless is really not relevant. The important fact is that, acting pursuant to the statute, the condemnor did so. Having exercised its statutory prerogative to sever the bridge and leave CNJ with ownership of a structure rendered useless by the serverance, the Government put CNJ in the position where, under the Bridge Act, it would have to bear the entire cost of the structure's removal as a hazard to navigation. Had the Government not caused the cessation of rail service, any mandated alteration or removal would have been governed by the Truman-Hobbs Act, 33 U.S.C. § 501, under which the Government would have had to bear nearly all, if not all, of the costs. (See J. S., 30).

We do not take issue with the Government's statement that the question of altering or removing the bridge because of alleged navigational hazards pre-dated the partial taking. The uncontroverted fact, however, is that the bridge was in rail service at the time of the taking; and it was not established that rail service over it would have been discontinued in the foreseeable future had there been no Rail Act and no partial taking. Indeed, all the evidence is to the contrary. (See J. S., 31-32).

As a result of the Rail Act and its implementation, the ruling below saddles CNJ with liability for bridge removal costs which, at the time of trial, were estimated by the Government at approximately $14,000,000.[7] The effect is to reduce the Special Court's award of approximately $42.5 million for the CNJ operating rail system to $28.5 million or less. We regard this as confiscatory by any standard and more in line with the kind of thinking evidenced in USRA's incredibly low valuations in the Final System Plan rather than with any concept of just compensation. We submit that the denial of severance damages was based on an erroneous legal concept of what facts are required to establish such damages, with resulting denial to CNJ of its constitutional right to just compensation therefor.

7. The Government has since raised its estimate to over $17,000,000. See Statement of Position of the United States of America and United States Railway Association with Respect to Petition for Supplemental Proceedings, *In the Matter of the Central Railroad Company of New Jersey*, No. B 401-67 (D.N.J. July 27, 1984) at 4-5.

CONCLUSION

These appeals present questions not previously passed upon by this Court which are of sufficient substantiality, merit and public interest to warrant plenary review at this time.

For the various reasons set forth in our Jurisdictional Statement and in this brief, this Court should deny the Government's motion for summary affirmance and note probable jurisdiction.

Respectfully submitted,

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